Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

WEST PENN POWER COMPANY,
ARMCO ADVANCED MATERIALS COMPANY
and ALLEGHENY LUDLUM CORPORATION,
Petitioners,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of Pennsylvania

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APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

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APPENDIX A

J-249-1992

IN THE SUPREME COURT OF PENNSYLVANIA
WESTERN DISTRICT

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHENY LUDLUM CORPORATION

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION

APPEAL OF: WEST PENN POWER COMPANY

No. 0109 W.D. Appeal Docket, 1991

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHENY LUDLUM CORPORATION

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION

APPEAL OF: PENNSYLVANIA PUBLIC
UTILITY COMMISSION

WEST PENN POWER COMPANY,
Appellee

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellant

No. 0110 W.D. Appeal Docket, 1991

ARMCO ADVANCED MATERIALS CORPORATION and ALLEGHENY LUDLUM CORPORATION,
Appellants

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Appellee

WEST PENN POWER COMPANY

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION

APPEAL OF: ARMCO ADVANCED MATERIALS CORPORATION and ALLEGHENY LUDLUM CORPORATION

No. 0111 W.D. Appeal Docket, 1991

Appeals from the Orders of the Commonwealth Court Entered July 17, 1990 at Nos. 2074 and 2092 C.D. 1989, Affirming in Part and Modifying in Part the Order of the Pennsylvania Public Utility Commission Entered September 29, 1989 at No. P-870216.

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135 Cmwlth. Ct. 15, 579 A.2d 1337 (1990)

ARGUED: September 24, 1992

ORDER

PER CURIAM DECIDED: NOVEMBER 24, 1993

Order affirmed.

MR. JUSTICE LARSEN did not participate in the decision of this case.

MR. CHIEF JUSTICE NIX, MR. JUSTICE CAPPY and MR. JUSTICE MONTEMURO affirm.

MESSRS. JUSTICE FLAHERTY, ZAPPALA and PAPADAKOS affirm in part and would reverse in part.

MR. JUSTICE PAPADAKOS files a Concurring and Dissenting Opinion in which MESSRS. JUSTICE FLAHERTY and ZAPPALA join.

JUDGMENT ENTERED THIS 24TH DAY OF NOVEMBER, 1993.

/s/ Irma T. Gardner
IRMA T. GARDNER
Deputy Prothonotary

J-249-1992

IN THE SUPREME COURT OF PENNSYLVANIA
WESTERN DISTRICT

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PENNSYLVANIA PUBLIC UTILITY COMMISSION,
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135 Cmwlth. Ct. 15, 579 A.2d 1337 (1990)
ARGUED: September 24, 1992

CONCURRING AND DISSENTING OPINION

MR. JUSTICE PAPADAKOS DECIDED: NOVEMBER 24, 1993

I respectfully dissent to this court's decision to affirm by Per Curiam Order the decision and opinion of the Commonwealth Court. I believe that the Commonwealth

Court was in error in its holding as to Phase I but correct as to Phase II as hereinafter explained.

This case arises under the ratemaking authority of the Pennsylvania Public Utility Commission ("PUC"). Ultimately this dispute originates in the fact that in 1978, Congress enacted the Public Utility Regulatory Policies Act of 1978 ("PURPA"), codified relevant to this case at 16 U.S.C. § 796(17)-(22) and 16 U.S.C. § 824a-3. PURPA *requires* that, amongst other things, regulated electric utilities offer to purchase electric energy from alternative power sources in the form of cogeneration and small power production facilities, thereby reducing this country's dependence on foreign oil and natural gas. PURPA also envisions the promotion of energy conservation and encourages the development of alternative energy sources. The Federal Energy Regulatory Commission ("FERC") subsequently issued regulations under the statute. See, 18 C.F.R. § 292, *et seq*. Under the statute and the regulations, qualified cogeneration and small power production facilities are referred to as qualifying facilities ("QFs") and must be certified by FERC as such. Congress, however, chose *state* regulatory authorities to be the prime enforcers of PURPA. The statute *requires* state regulatory agencies to implement FERC's rules in this area. This rather convoluted scheme of federal preemption was upheld by the United States Supreme Court in *Federal Energy Regulatory Commission v. Mississippi*, 456 U.S. 742, 102 S.Ct. 2126, 72 L.Ed.2d 532 (1982). The Pennsylvania Public Utility Commission has enacted its own regulations implementing FERC's PURPA regulations at 52 Pa. Code § 57.31, *et seq*.

While FERC has exercised its regulatory authority under PURPA to *require* a rate for certain utility purchases from QFs *equal* to "full avoided cost" (discussed further below), FERC regulations also permit (nay, encourage) utilities and QFs to negotiate agreements for utility purchases of power independently of the prescribed rates.

18 C.F.R. § 292.301. However, these agreements cannot be for amounts higher than the utility's "avoided costs."

Pursuant to this latter federal policy, West Penn Power Company ("West Penn") began negotiating on November 20, 1985, with Milesburg Energy, Inc. ("MEI") directly concerning MEI's proposal to refurbish an old West Penn power plant and create an electric generating facility fueled by bituminous coal refuse designed to provide up to 43 megawatts of power for a period of 30 years. This project is commonly known as the Milesburg Project and is located in Milesburg, Centre County, Pennsylvania. As of the date of this writing, and in the face of lengthy litigation, this project has yet to be built!

West Penn quoted rates for both capacity costs and energy costs for the purchase of power and MEI agreed to those rates on May 7, 1986, forming an agreement in principle on price. The rates were based on West Penn's own determination of its "avoided costs" and were calculated to be *at or below* its "avoided costs" as of May 7, 1986. FERC regulations define "avoided costs" as "the incremental costs to an electric utility of electric energy or capacity or both which, but for the purchase from the qualifying facility or facilities, such utility would generate itself or purchase from another source." 18 C.F.R. § 292.101(b)(6). Unlike avoided energy costs, which are relatively stable and are not at issue in this appeal, avoided *capacity* costs, as will be seen below, can vary significantly over time. They are time dependent. The avoided *capacity* rate agreed to would have resulted in capacity payments of approximately $10 million per year by West Penn to MEI over the 30 year period for the purchase of electric power.

A further word about "avoided costs" is in order. Prior to PURPA, cogeneration and small power production facilities could not force utilities to purchase their electricity output and could only negotiate with utilities for the purchase of their power under the ordinary commer-

cial circumstances of a willing buyer and a willing seller. In PURPA, Congress directed the FERC to set rates for utility purchases of power from QFs for ultimate resale to the utility's retail customers that are: (1) just and reasonable to the electric consumers of the utility and in the public interest; (2) not discriminatory against QFs; and (3) not to exceed the "incremental costs of alternative electric energy." 16 U.S.C. § 824a-3(b). PURPA defines the term "incremental costs of alternative electric energy" as the cost to the utility of electric energy which the utility would have generated or purchased from another source, absent the purchase from the QF. 16 U.S.C. § 824a-3(d). The concept of paying QFs the same or lesser amount as the utility would have charged for a like amount of power is commonly referred to as avoided cost pricing. 18 C.F.R. § 292.304. The Congressional intent of the avoided cost pricing scheme is to make the utilities' ratepayers economically indifferent between utility power plant additions and utility purchases of QF power.

> Under Section 210 of PURPA an electric utility's ratepayers are intended to be at least indifferent, in terms of the rates they pay, as to the source of power. In other words, the ratepayer is not to pay any more for power because the utility has purchased power from a QF rather than generating the power itself or purchasing power from another wholesale source. This is the purpose underlying the incremental cost ceiling on the rates utilities have to offer to purchase QF power.

Federal Energy Regulatory Commission, *Notice of Proposed Rulemaking: Administrative Determination of Full Avoided Costs, Rates for Sales of Power to Qualifying Facilities, and Interconnection Facilities*, Docket No. RM88-6-000 (March 16, 1988) at p. 7, (citing Conference Report on PURPA, H.R. Rep. No. 1750, 95th Cong., 2nd Sess. 98, reprinted in 1978 U.S. Code Cong. and Ad. News 7797, 7832); Summary of proposed rule-

making contained at 53 Fed. Reg. 9331 (March 22, 1988).

In other words, Congress sought to encourage the development of alternate energy sources provided that such development was not to be at all painful to either electric utilities or their ratepayers! "Avoided costs" therefore serve as a maximum price that QFs can charge utilities where the contract between the two is "freely" negotiated.

After further negotiations and based on their agreement in principle on price, MEI and West Penn voluntarily entered into an Electric Energy Purchase Agreement ("EEPA") dated February 25, 1987, whereby West Penn agreed to purchase electric power from the Milesburg Project (utilizing avoided *capacity* costs as of May 7, 1986) subject to certain terms and conditions. The EEPA contained a series of milestone dates designed to assure West Penn that satisfactory progress was being made on the project so that it could rely upon MEI's commitment to deliver power. One of the key milestone dates was the deadline for the closing of the initial construction financing of the Milesburg project (known as the "Financing Closing Date"). The EEPA provided that it would automatically terminate if the Financing Closing Date did not occur before September 1, 1988, for any reason whatsoever, including *force majeure*. A financing closing on the Project has not occurred to date. The parties also agreed in the EEPA that, as a condition precedent of West Penn's obligations to purchase power, the PUC must enter an order, final beyond appeal, establishing that the EEPA was in full compliance with the law and public policy, that the purchase of power would not resut in excess capacity, and that all amounts paid by West Penn under the EEPA were consistent with law and could be immediately and fully passed through to its customers. This condition precedent was thought to be necessary because, as a public utility, West Penn cannot pass through to its customers any costs incurred under an EEPA without the authorization of the PUC.

On April 2, 1987, West Penn filed a petition with the PUC seeking an order declaring that the EEPA complied with PURPA and the Public Utility Code and that West Penn was authorized to pass through all costs incurred under the EEPA to its customers ("West Penn's Approval Petition"). Various parties intervened and the PUC in substance granted West Penn's petition without, however, holding open hearings on the matter. On appeal, the Commonwealth Court held that adequate notice to customers of the utility, and a fair opportunity to be heard—as required by due process, had not been given prior to PUC consideration of West Penn's Approval Petition. The Commonwealth Court remanded the matter for further proceedings that included the requirement that notice and an opportunity to be heard be afforded to West Penn's ratepayers. This decision of the Commonwealth Court was rendered on August 22, 1988, in *Barasch v. Pennsylvania Public Utility Commission*, 119 Pa. Commonwealth Ct. 81, 546 A.2d 1296 (1988), *reargument granted in part*, 119 Pa. Commonwealth Ct. 115, 550 A.2d 257 (1988); now referred to as "Milesburg I." We denied further review, and the matter was returned to the PUC. On February 8, 1989, MEI filed a petition requesting the PUC to grant it relief from the Financing Closing Date and all other milestone dates in the EEPA ("MEI Modification Petition").

From April 3 through April 12, 1989, an Administrative Law Judge conducted an extensive PUC hearing (which produced a transcript of 1,475 pages) on both West Penn's Approval Petition (which came to be known as the "Phase I proceeding"), and on MEI's Modification Petition and related pleadings (which came to be known as the "Phase II proceeding"). The Administrative Law Judge issued his Recommended Decision on June 27, 1989, granting West Penn's Approval Petition but denying MEI's Modification Petition on the grounds that the EEPA between West Penn and MEI had lapsed and could not be modified (the lapse date being September 1, 1988).

On September 29, 1989, the PUC entered an Opinion and Order in this case, with one Commissioner dissenting, granting West Penn's Approval Petition (Phase I). With regard to MEI's Modification Petition, the PUC agreed that the contract had lapsed but granted MEI its relief anyway (Phase II). In granting West Penn's Approval Petition, the PUC held to their previously announced policy in earlier cases involving voluntary agreement to the effect that "avoided costs" are to be determined as of the time of serious negotiations between parties. This was in agreement with the Administrative Law Judge's recommendation. In dealing with MEI's Modification Petition and a related petition of West Penn to withdraw its Approval Petition because the EEPA lapsed by its very terms, the PUC reversed the Administrative Law Judge's recommended decision and ordered, pursuant to its belief that it had general regulatory authority under the PURPA regulations to modify power purchase contracts between a utility and a QF, that West Penn enter into a new EEPA with MEI with terms and conditions identical to those in the former contract but with the first milestone date extended until six months after the entry of a final non-appealable order in this case with corresponding extensions of related milestone dates, all in accordance with the request by MEI.

West Penn appealed the Phase II portion of the Opinion and Order of the PUC to the Commonwealth Court arguing that the PUC's order improperly took a lapsed, voluntary PURPA contract and turned it into an involuntary PUC-ordered contract under terms contrary to the FERC's PURPA regulations.

Intervenors, Armco Advanced Materials Corporation and Allegheny Ludlum Corporation ("Armco/Ludlum"), two large industrial customers of West Penn, also jointly appealed the Opinion and Order of the PUC to the Commonwealth Court. They appealed the PUC's rulings on both West Penn's Approval Petition (Phase I) and MEI's Modification Petition (Phase II).

The Commonwealth Court consolidated the appeals and by a Memorandum Opinion and Orders filed July 17, 1990, affirmed in part and modified in part the PUC's Order entered September 29, 1989. The Commonwealth Court, in accord with Armco/Ludlum's argument, modified the PUC's approval of the EEPA by requiring that the calculation of avoided *capacity* costs reflect factors in existence at the time the EEPA was executed (February 25, 1987), rather than at the time of serious negotiations between the parties (May 7, 1986). (Phase I). In addition, the Commonwealth Court affirmed the PUC's Order requiring West Penn to enter into a new, involuntary EEPA with MEI with an extended EEPA Financing Closing Date and with corresponding extensions in the related milestone dates.

The PUC has appealed the Commonwealth Court's modification of the Phase I portion of the PUC's order to this Court; and West Penn and Armco/Ludlum have appealed the Commonwealth Court's affirmance of the PUC's Phase II order.

We granted allocatur because at least part of the Commonwealth Court's decision appears to conflict with sound principles of administrative review enunciated by this Court. I will deal with Phase I and Phase II of the PUC order (and the Commonwealth Court's review thereof) separately.

Phase I

As noted, the Commonwealth Court modified the PUC's approval of West Penn's Approval Petition in Phase I by holding that avoided *capacity* costs must be calculated as of the date the EEPA was formally executed, February 25, 1987, rather than at the time of serious negotiations between the parties (specifically as of the date an agreement in principle was reached on price —May 7, 1986). The Commonwealth Court based their conclusion on a reading of a FERC regulation, 18 C.F.R. § 292.304(d), discussed below. To further complicate

matters, Armco/Ludlum now argues that the relevant calculation date is either September 29, 1989, the date when the PUC ordered West Penn to enter into a new transaction based on the original EEPA (which had expired according to its own terms); or, in the alternative, on the date MEI became certified as a QF, January 28, 1988. It is not readily apparent why this date selection question has been so bitterly litigated. However, a careful reading of the record and briefs in this case reveals the answer. Originally, Armco/Ludlum argued for the February 25, 1987, date because two tax changes occurred prior to that date that they wanted incorporated into the calculation of the capacity credits for Milesburg, namely, the Tax Reform Act of 1986, effective in tax year 1987 and beyond, and a reduction in Pennsylvania Corporate Net Income Tax effective January 1, 1987. See, the PUC decision in this case, *Re: West Penn Power Company*, 106 PUR 4th 459, at 465 (1989). Although precise calculations are not available, picking the later 1987 date with the tax changes then in effect, Armco/Ludlum argues, would reduce the rates charged to utility customers as a result of the Milesburg project. Armco/Ludlum further argues that picking an even later date in 1988 or 1989 might effectively eliminate rate increases completely. See, Armco/Ludlum Appellants' brief at pp. 43-44. The self-serving shifting of dates by Armco/Ludlum for the calculation of avoided capacity costs emphasizes the correctness of the rationale employed by the PUC.

The PUC herein ruled that the avoided cost figures as of the time of *serious negotiations between the parties* should be used in determining the capacity rates for energy purchases by electric utilities from QFs. The PUC found that if it were to hold otherwise, avoided costs would become a constantly moving target, a phenomenon that would undermine contract negotiations that chill the continued development of cogeneration and small power production. 104 PUC 4th, at 464. This fear seems well

founded. Moreover, the PUC adopted the Administrative Law Judge's position that no matter what point in time is used to fix rates, ratepayers will bear the risk that rates will go down and QFs will bear the risk that they will go up. Some point in time must be fixed and the PUC chose to continue to follow and to apply their "serious negotiations" rule, adopted in a case by case method and having been most recently enunciated and applied in *Pennsylvania Public Utility Commission v. Duquesne Light Co.*, 64 Pa. P.U.C. 388 (1987).

The Commonwealth Court thought that the *serious negotiations rule* (which made applicable the May 7, 1986, date when an agreement on price was reached in principle between West Penn and MEI) should not be applied here because it conflicted with a FERC regulation at 18 C.F.R. § 293.304(d). The FERC regulation provides in part:

> (d) Purchases "as available" or pursuant to a legally enforceable obligation. Each qualifying facility shall have the option either:
>
> . . . . .
>
> (2) To provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:
>
> (i) The avoided costs calculated at the time of delivery; or
>
> (ii) The avoided costs calculated at the time the obligation is incurred. (Emphasis added).

The critical phrase, of course, is "legally enforceable obligation." It would be a rare person, indeed, who would argue that that phrase is susceptible of one and only one meaning, without nuance or variation, in every

given situation. I think it can be reasonably argued that there is no conflict between the FERC regulation and the PUC's serious negotiations standard as applied in this case. We are not, after all, dealing with completely free enterprise. We are, rather, dealing with the twilight world of regulated monopolies. "[A utility's] obligation is not governed by common law concepts of contract law; it is created by statutes, regulations and administrative rules. . . ." *Snow Mountain Pine Co. v. Mauldin*, 734 P.2d 1366, 1370, 84 Or.App. 590, 598-599; *review denied*, 739 P.2d 571, 303 Or. 591 (1987).

In this twilight world, one party may be bound to a contract while the other is not. While it is conceded by all that the May 7, 1986, agreement in principle on price did not bind MEI to go through with the deal, it did bind West Penn in that they were bound to that specific pricing system they agreed to in principle once the contract was signed and, as Phase II of these proceedings makes clear, under PURPA, West Penn could be *compelled* by the PUC to enter into a contract on those agreed to prices at a later date, regardless of escape clauses or agreements to the contrary. MEI was in effect given an option when the agreement in principle on price was reached and while other contingencies had to be met, the agreement on price was firm and binding MEI's favor, otherwise why have it? It was essential that these prices be fixed at an early date so that MEI's development mortgage lender could calculate its cash flow to determine whether a mortgage on the property would be a sound investment. In short, while not a full contract, the agreement in principle on price did have a binding quality to it under these unique circumstances.

That is all that is necessary to bring the serious negotiations standard in compliance with the FERC regulation on "legally enforceable obligation" for *it is reasonable to argue, as noted above, that the two do not conflict*. Once that conclusion is reached, it falls primarily

within the agency's discretion to interpret and apply its own rules and regulations. *Norfolk & W. Railway Co. v. Pennsylvania Public Utility Commission*, 489 Pa. 109, 413 A.2d 1037 (1980); *Commonwealth v. Beck Elec. Constr., Inc.*, 485 Pa. 604, 403 A.2d 533 (1979); *State Dental Council v. Pollock*, 457 Pa. 264, 318 A.2d 910 (1974). While I agree that here the PUC is applying federal regulations rather than their own, we think that the same rule must apply. The courts should refrain from making policy rulings for an agency unless the agency's acts are clearly illegal. That is not what occurred here. Court meddling with these types of questions invites the sort of lengthy litigation and delay that is so detrimental, particular in a case like this one.

For the reasons set forth above, I believe that the Commonwealth Court was in error not to defer to agency discretion in this matter and hence I would reverse the Commonwealth Court on this point and reinstate the PUC's decision to calculate avoidance costs as of May 7, 1986.

Phase II

The PUC agreed with their Administrative Law Judge that the Milesburg EEPA had lapsed according to its own terms. Nonetheless, the PUC held that despite the lapsed agreement, West Penn had a legally enforceable obligation to purchase power from MEI under the lapsed 1987 EEPA and at rates determined in accordance with West Penn's avoided costs calculated as of May 7, 1986, because such was mandated by Section 210 of PURPA, 16 U.S.C. § 824a-3. The Commonwealth Court affirmed finding that a negotiated contract conditioned on PUC approval is not a privately negotiated contract contemplated by 18 C.F.R. § 202.301, and that FERC has granted state public utility commissions broad authority under Section 210 of PURPA and that under that section a PUC has broad plenary power to order a utility to enter into a contract with a QF. Moreover, the Com-

monwealth Court concluded that a utility's submission of a contract with a QF to the PUC for approval is the legal equivalent to a petition by the QF to the PUC to compel the utility to enter into that contract. This all seems correct under PURPA, and we should not disturb the Commonwealth Court's conclusions in this matter. Under this theory giving plenary power to the PUC, the agency must order a rate equivalent to full avoided costs, 18 C.F.R. § 293.304(b)(2).

None of the parties to this appeal has challenged the fact that the PUC has done that by chosing to use the May 7, 1986, calculations in accordance with their "serious negotiations" rule. Hence, the PUC resolution of Phase II does not disturb their, and my, analyses under Phase I. Of course, under the plenary power given under PURPA, the PUC was free to order changes in some of the terms of the EEPA and this they did, including making changes in certain "milestone" dates. This they were entitled to do and I find no error here.

I would reverse the Commonwealth Court decision as to Phase I and affirm its decision as to Phase II.

MR. JUSTICE FLAHERTY and MR. JUSTICE ZAPPALA join this Concurring and Dissenting Opinion.

APPENDIX B

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 2092 C.D. 1989

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHENY LUDLUM CORPORATION,
Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

No. 2074 C.D. 1989

WEST PENN POWER COMPANY,
Petitioner

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

BEFORE:

HONORABLE JAMES CRUMLISH, JR.,
President Judge
HONORABLE DAVID W. CRAIG, Judge
HONORABLE JAMES GARDNER COLINS, Judge
HONORABLE MADALINE PALLADINO, Judge
HONORABLE BERNARD L. MCGINLEY, Judge
HONORABLE DORIS A. SMITH, Judge
HONORABLE DAN PELLEGRINI, Judge

ARGUED:

APRIL 4, 1990

OPINION BY JUDGE CRAIG FILED: July 17, 1990

In several cases, including an earlier appeal involving this project, captioned *Barasch v. Pennsylvania Public Utility Commission,* 119 Pa. Commonwealth Ct. 81, 546 A.2d 1296, *reargument denied,* 119 Pa. Commonwealth Ct. 115, 550 A.2d 257 (1988) (*Milesburg I*), this court has considered various procedural questions concerning the implementation by the Pennsylvania Public Utility Commission (PUC or Commission) of the federal legislation and regulations designed to encourage the development of cogeneration and small power production from alternative energy sources.

In the present appeals, the other shoe has now dropped, and the issues concern substantive limits on the power of the PUC to approve recovery from ratepayers of costs that an electric utility, West Penn Power Company (West Penn), will incur pursuant to an order of the PUC directing West Penn to enter into an electric energy purchase agreement (EEPA or contract) with Milesburg Energy, Inc. (MEI), which is a "qualifying facility" (QF) for the purposes of section 210 of the Public Utility Regulatory Policies Act of 1978 (PURPA).[1] Armco Advanced Materials Corporation and Allegheny Ludlum Corporation

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[1] 16 U.S.C. § 824a-3. For discussions of the public policy objectives that Congress sought to promote in enacting PURPA and the promulgation of regulations implementing PURPA by the Federal Energy Regulatory Commission (FERC) see *Milesburg I* and *Lehigh Valley Power Committee v. Pennsylvania Public Utility Commission,* —— Pa. Commonwealth St. ——, 563 A.2d 548 (1989). PURPA defines "cogeneration facility" as one that produces both electric energy and steam or some other form of useful energy, such as heat, 16 U.S.C. § 796(18)(A), and it defines "small power production facility" as one that has a maximum production of no more than 80 megawatts (MW) and uses as a primary energy source biomass, waste, geothermal resources or renewable resources such as wind, water, or solar energy to produce electric power, 16 U.S.C. § 796(17)(A). Together they are known as "qualifying facilities".

(Armco/Allegheny), two large industrial customers of West Penn, and West Penn itself have appealed from the Commission's order.

The principal questions presented are (1) whether the PUC had the authority to order payment to a QF of capacity credits [2] reflecting avoided costs calculated at a time before the QF had made a commitment to deliver capacity, where the applicable FERC regulation requires calculation of avoided costs when the QF has incurred a "legally enforceable obligation for the delivery of energy or capacity", and (2) whether the PUC had the authority to order West Penn to enter into a new EEPA with MEI, after the first contract automatically terminated upon the expiration of a contract deadline, where the new contract has a higher but as yet undetermined capacity rate, and the parties previously executed a consent decree stating that MEI would not seek or be entitled to a higher capacity rate.[3]

FERC Regulations Implementing PURPA

In section 210(a) of PURPA, 16 U.S.C. § 824a-3(a), Congress created a federal statutory duty requiring that electric utilities offer to purchase electric energy from qualifying facilities and directed FERC to prescribe rules

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[2] Energy costs are the variable costs associated with the production of electric energy—the cost of fuel and some operating and maintenance expenses. Capacity costs are those associated with providing the capability to deliver energy—primarily the capital costs of facilities. *See* 45 Fed. Reg. 12216, the commentary to the original publication of 18 C.F.R. § 292.101, the definitions section of the FERC regulations implementing PURPA.

[3] The present case is closely related to two other appeals involving EEPAs between West Penn and North Branch Energy Partners, L.P. for the Burgettstown Project (Nos. 2090 and 2097 C.D. 1989) and between West Penn and the Mon Valley Energy Corporation for the Shannopin Project (No. 2091 C.D. 1989), which the PUC considered and disposed of in the same proceeding as that involving the contract between West Penn and MEI.

implementing that duty. In section 210(b) Congress provided that the rates for such purchases should be just and reasonable to the utility customers and in the public interest, not discriminatory against QFs, and not above the "incremental cost of alternative electric energy", thereby assuring that the overall effect on ratepayers of the PURPA program would be neutral. In section 210(f), Congress designated state regulatory authorities, with their expertise and unique knowledge of local conditions, to be the primary enforcers of PURPA by implementing FERC's rules.

FERC's rule relating to state regulatory authority implementation, 18 C.F.R. § 292.401, provides in part:

> (a) *State regulatory authorities.* Not later than one year after these rules take effect, each State regulatory authority shall, after notice and an opportunity for public hearing, commence implementation of Subpart C [relating to arrangements between utilities and QFs under section 210 of PURPA] . . . . Such implementation may consist of the issuance of regulations, an undertaking to resolve disputes between [QFs] and electric utilities arising under Subpart C, or any other action reasonably designed to implement such subpart . . . .[4]

FERC's rule relating to rates for purchases by utilities from QFs is 18 C.F.R. § 292.304. In § 292.304(b)(2), FERC exercised its discretion by requiring rates equal to the utility's full "avoided costs" (FAC), defined in § 292.101(b)(6) as "the incremental costs to the electric utility of electric energy or capacity or both which,

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[4] Part of the commentary relating to this regulation in the Preamble to the publication of the FERC rules states, "These rules afford the State regulatory authorities . . . great latitude in determining the manner of implementation of the Commission's rules, provided that the manner chosen is reasonably designed to implement the requirements of Subpart C." 45 Fed. Reg. 12230-31 (February 25, 1980).

but for the purchase from the qualifying facility or qualifying facilities, such utility would generate itself or purchase from another source." [5]

The FERC regulations permit a utility and a QF to negotiate privately and *to agree* to terms different from those prescribed. 18 C.F.R. § 292.301(b). Where, as in the present case, a utility and a QF negotiate a contract, but the utility conditions its obligation to purchase on preapproval from the state PUC of recovery from ratepayers of the contract costs, and submits the contract to the PUC to obtain such approval, the situation does not involve the private agreement contemplated by § 292.-301(b). The state PUC's review of such a petition appears to be proper under the § 292.401 grant of authority to take "any other action reasonably designed to implement [Subpart C of the regulations]." In such a case, the state PUC must make a calculation of FAC in order to determine whether the contract rate is at or below FAC and hence reasonable and recoverable.[6]

The PUC elected to implement the FERC rules by promulgating its own regulations contained in 52 Pa. Code §§ 57.31-57.39. *See* 12 Pa. B. 4237 (December 11,

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[5] The United States Supreme Court upheld FERC's decision that rates reflecting *full* avoided cost, rather than passing some of the savings typically realized by cogeneration or small power production on to ratepayers, are just and reasonable to consumers and in the public interest in *American Paper Institute, Inc. v. American Electric Power Service Corp.*, 461 U.S. 402 (1983).

[6] The due process violation that this court identified in *Milesburg I* masked a potential substantive violation in this regard. The PUC calculated a value for FAC and approved the contract capacity rate because it reflected a lower figure. Because the PUC failed to provide notice and a hearing, however, no one had the opportunity to point out that the PUC's failure to make its calculations part of the record meant that no one had any way of knowing how the PUC had arrived at its figure. In regard to its approval of a collection of some $10 million per year, the PUC was asking the utility's ratepayers simply to trust it.

1982). Section 57.32(a) of the PUC's regulations states, "The purpose of this subchapter is to implement the provisions of section 210 of the Public Utility Regulatory Policies Act of 1978 . . . ."

History

MEI and West Penn began negotiating on November 20, 1985, concerning MEI's proposal to establish a 43 megawatt (MW) small power production facility to be fueled by bituminous coal refuse at the site of West Penn's retired Milesburg Power Station (Milesburg Project). West Penn asserts that it reached an oral agreement in principle with MEI on the capacity rate it would pay on May 7, 1986.

On May 27, 1986, West Penn submitted a written price offer to MEI with three different capacity rates for different in-service dates of the facility. The written offer stated that it was valid for six months only, subject to modification for changes in the facility's characteristics, and subject to approval by West Penn's Board of Directors. The capacity rates reflected a federal corporate income tax rate of 46% and a state corporate income tax rate of 9.5%, as well as May 24, 1985, financial forecasts and West Penn's projected need for a generating plant with three 300 MW coal-fired units scheduled to be on-line in 1995, 1997 and 1998, as set forth in the May 1, 1986, Allegheny Power System Generation Capacity Plan. The parties completed a Final Term Sheet on October 27, 1986, which included a provision stating that the term sheet was solely for the convenience of the parties as a basis for ongoing negotiations, not binding on either, and might be changed as to any term, including the amount West Penn would pay for energy from the Milesburg Project.

On February 25, 1987, West Penn and MEI formally entered into an Electric Energy Purchase Agreement (EEPA or contract) containing rates based on the esti-

mated avoided costs noted above. West Penn's obligations were conditioned on certification of the Milesburg Project by FERC as a QF, and the existence of a PUC rule or order, final beyond appeal, approving the legality of the contract and rate recovery of West Penn's costs under it. In addition, the EEPA provided for a series of milestone dates, including the Financing Closing Date (date of first closing of initial construction financing) and provided that if that milestone date did not occur "prior to September 1, 1988 for any reason whatsoever, including Force Majeure, this Agreement shall automatically terminate, in which case neither party shall have any further liability to the other hereunder." Armco/Allegheny Exhibit 11 at Section 10.2; R. 65a.

West Penn filed a petition with the PUC on April 2, 1987, requesting an order approving the legality of the contract terms under PURPA and the Public Utility Code and authorizing West Penn to pass its costs under the contract through to ratepayers. Without holding a hearing or making its calculations part of the record, the PUC concluded that the contract capacity rate of 3.3 cents per kilowatt (KWH) hour was less than the PUC's calculated maximum legal rate and so per se reasonable. The PUC entered an order on September 22, 1987, approving the terms of the EEPA and authorizing West Penn to recover its costs. The Office of Consumer Advocate (OCA), West Penn and Armco/Allegheny appealed that order to the Commonwealth Court.

On August 3, 1988, MEI filed a petition requesting the PUC to exercise its authority under section 508 of the Public Utility Code, 66 Pa. C.S. § 508,[7] to relieve

[7] This section authorizes the PUC to vary, reform or revise, upon a fair, reasonable and equitable basis, any obligations, terms or conditions of any contract between a utility and a person, corporation or municipal corporation that embrace or concern a public right or are affected or concerned with the public interest. The PUC must provide notice and a hearing before determining that a

MEI from the September 1, 1988, Financing Closing Date and all other later deadlines in the EEPA.

This court issued its decision on the appeals of the PUC order approving the contract, *Milesburg I*, on August 22, 1988. We held that before the PUC may approve the legality of a contract for a utility's purchase of power from a QF that includes substantial payments for capacity, due process requires that the utility's ratepayers must be provided with notice of the proceedings and an opportunity to be heard to challenge the proposed action, because such approval by the PUC is adjudicatory in nature and involves substantial property rights of ratepayers. We reversed and remanded for the PUC to reconsider its order after providing adequate notice to ratepayers and an opportunity for them to be heard. The PUC petitioned for reargument.

On September 1, 1988, the PUC adopted a Consent Order entered into by all interested parties that extended the Financing Closing Date in the EEPA to February 28, 1989, unless extended by further order of the PUC, and provided that in any hearing pursuant to this court's order in *Milesburg I* the PUC would consider and determine whether it should order a further extension of the Financing Closing Date. The Consent Order also stated that MEI would not seek or be entitled to any capacity credit higher than that specified in the existing contract. On November 3, 1988, this court denied the PUC's petition for reargument and clarified the court's decision in *Milesburg I* by stating that the rule announced there would be applied prospectively, only. The PUC regained jurisdiction over the proceeding on December 5, 1988, and, on January 19, 1989, entered an order consolidating the Milesburg proceeding for purposes of hearing and decision with three other petitions for approval of EEPAs

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contractual provision is subject to modification, and it must prescribe the appropriate new provisions. The modified contract takes effect thirty days after service of the PUC's order on the parties.

between West Penn and QFs, including those involving the Burgettstown Project and the Shannopin Project.

As the extended Financing Closing Date approached, MEI filed a second modification petition based on section 508 of the Public Utility Code with the PUC, on February 9, 1989, requesting that the EEPA be changed to make the Financing Closing Date 120 days after a final nonappealable PUC order approving the contract. That petition also requested an increase in the capacity rate.

The Administrative Law Judge (ALJ) to whom the case had been assigned granted the relief requested on February 21, 1989, but he rescinded his order on February 27 because no section 508 hearing had been held. On March 3, 1989, MEI filed a petition for an interim emergency order or appeal from the ALJ's February 27 order. West Penn filed a petition for leave to withdraw its original petition for approval of the EEPA on the grounds that the contract had terminated automatically because of MEI's failure to meet the extended Financing Closing Date, and Armco/Allegheny filed a motion to dismiss the original petition on the same grounds. By order entered March 31, 1989, the PUC denied MEI's petition for an emergency order but required all parties to maintain the status quo pending a consideration of the underlying February 9, 1989, modification petition.

The ALJ conducted a hearing on the four consolidated cases over eight days in April of 1989. Although this court in *Milesburg I* had directed the PUC to make its calculation of West Penn's full avoided cost part of the record and to make it available to interested parties before the hearing, no member of the PUC's legal or technical staff participated in the hearing, and the PUC did not make its own calculation of West Penn's full avoided cost with regard to any of the QFs part of the record.[8]

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[8] After the hearing had started, a counsel for the PUC sent a letter to the ALJ with an attached calculation of the proper capacity

The ALJ bifurcated the hearing into Phase One, concerning the ratemaking issue of the proper capacity rates to be paid to the QFs, and Phase Two, concerning the petition for modification filed by MEI and a similar petition filed by North Branch in regard to the Burgettstown Project, seeking relief from the effect of various contract deadlines, which the developers said they could not meet solely because of litigation delays. As to Phase One, no party challenged the overall method of calculating the avoided costs that was employed by West Penn for all of the contracts, which is somewhat different from the method provided in the PUC's regulation at 52 Pa. Code § 57.34(c)(1), and, the parties agree, yields a lower result. However, Armco/Allegheny challenged various inputs used in the calculation.

The ALJ issued his Recommended Decision on June 27, 1989. On the Phase One issues, the ALJ approved the use of West Penn's method of calculating FAC in these proceedings, while rejecting an attack by OCA on the propriety of the method provided in the PUC's regulations. He concluded that the time of agreement in principle on rates employed by West Penn satisfied the PUC's "time of serious negotiation" standard for determining the point at which to calculate FAC, and he declined to disapprove the use of that standard. Therefore, he concluded that the inputs in West Penn's calculations of FAC were reasonable, and hence that the various capacity credits, including those in the contract with MEI, were at or below West Penn's full avoided costs as determined by either West Penn's formula or the PUC's regulations.

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rate for a QF with an on-line date of 1990, pursuant to the formula provided in the PUC's regulation, 52 Pa. Code § 57.34(c)(1). The letter stated that the attachment was a "personal" calculation, not binding in any way upon the PUC. The ALJ admitted the calculation into the record, but he stated that the unsponsored exhibit was classic hearsay, to which he could give no weight.

On the Phase Two issues relating to MEI, the ALJ determined that the contract between MEI and West Penn had lapsed and therefore could not be modified. Although he acknowledged that West Penn had a duty under PURPA to purchase from a QF such as the Milesburg Project, he concluded that West Penn was not required to do so under a lapsed contract, reasoning that the unforeseen delays caused by the litigation in this case are part of the risk that any developer must bear and that MEI accepted that risk when it entered into the original contract. He also concluded that the Consent Order should operate to bar any increase in the capacity rate for MEI, even if the PUC concluded that the EEPA had not lapsed or was subject to revival.

On September 29, 1989, the PUC entered an order adopting the ALJ's recommendation with regard to the Phase One issues but reversing as to the Phase Two issues. The Commission ordered West Penn to enter into a new EEPA with MEI, with terms and conditions identical to those of the former contract but with the first milestone date extended until six months after the order became final and nonappealable and with a capacity rate increase reflecting the later in-service date of the facility.

Phase One—Time Frame

In its opinion, the PUC adopted the ALJ's recommendation that West Penn's use of the time of agreement in principle on rates complied with the PUC's standard of time of serious negotiations between the parties as set forth in *Pennsylvania Public Utility Commission v. Duquesne Light Co.*, 64 Pa. P.U.C. 388 (1987). The PUC reiterated its "longstanding policy that avoided costs are to be determined as of the time of serious negotiations." *Re West Penn Power Co.*, —— Pa. P.U.C. ——, ——, 106 PUR 4th 459, 466 (1989).[9] The PUC en-

[9] On this appeal, West Penn has changed its position and now joins Armco/Allegheny in arguing that under the FERC regula-

dorsed the ALJ's comment that no matter what time is used to fix EEPA purchase rates, ratepayers bear a risk that avoided costs will go down and QFs bear a risk that they will go up, and it rejected Armco/Allegheny's argument that time of contract execution should control, for the reasons set forth in the reply exceptions of West Penn and the QFs.

In its argument here, Armco/Allegheny notes that a state PUC must apply the FERC regulations in all circumstances except those involving a freely negotiated and executed contract under 18 C.F.R. § 292.301. Where a state PUC must calculate a value for avoided costs, the time as of which those costs are calculated obviously is all-important.

The crucial FERC regulation provides in part as follows:

> (d) *Purchases 'as available' or pursuant to a legally enforceable obligation.* Each qualifying facility shall have the option either:
>
> . . .
>
> (2) To provide energy or capacity pursuant to a *legally enforceable obligation for the delivery of energy or capacity* over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:
>
> (i) The avoided costs calculated at the time of delivery; or
>
> (ii) The avoided costs calculated *at the time the obligation is incurred.*

18 C.F.R. § 292.304(d) (emphasis added). We note that the "legally enforceable obligation" involved is that

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tions, the time of execution of the contract is the earliest time that may be used for calculating FAC. In the related appeal at No. 2091 C.D. 1989, involving the Shannopin Project, West Penn continues to argue in favor of the use of time of agreement in principle on price.

of the QF to deliver energy and capacity; MEI had no such obligation before the execution of the contract. Both the PUC and MEI concede that MEI could have walked away from the transaction at any time up to the moment of signing the contract with no legal liability whatsoever.

Despite the latitude and flexibility that FERC has afforded to state PUCs in view of their primary role in implementing section 210 of PURPA, a state PUC may not contravene the *substance* of FERC's rules.

Next the PUC refers to FERC's commentary in its Preamble relating to the combined effect of § 292.304(d) and § 292.304(b)(5), permitting rates based on estimates of avoided costs over the specific term of a contract or other legally enforceable obligation to differ from avoided costs at the time of delivery. 45 Fed. Reg. 12224.

The PUC interprets that language as not limiting the definition of avoided costs to those computed as of the time when the QF could be sued in court for damages or specific performance. The PUC asserts that the FERC regulations say nothing about the time frame for avoided cost projections. Noting that the FERC regulations distinguish between "contract" and "legally enforceable obligation", the PUC argues that *only* a contract duly signed by both parties could provide the basis for a suit. The PUC asserts that the "legally enforceable obligation" language was intended to permit a QF to lock in avoided cost projections unilaterally *before* the signing of a contract.

In our view, the PUC's interpretation of FERC's Preamble commentary is half right. The references in that commentary to a QF that has "entered into a contract . . . or agreed to obligate itself to deliver . . . energy and capacity", "obtained the certainty of an arrangement" and "enter[ed] into a commitment to deliver energy or capacity" clearly describe a QF that has made a binding commitment to deliver energy or capacity, not one, such as MEI at the time of agreement in principle on price,

that still has the right to decide whether it will sell power in the first place. Although the "legally enforceable obligation" language does permit a QF to lock in avoided cost projections even without a contract from a recalcitrant utility, the phrase does not encompass a QF that has incurred no obligation at all.

The PUC next points to its regulations implementing the federal regulations and asserts that its regulations permit QFs to lock in avoided costs projections by an "offer of acceptance" of a particular capacity cost credit. The PUC's formula for calculating capacity credits, in 52 Pa. Code § 57.34(c)(1), contains the term "CE", defined as "A utility's total estimated cost of construction of a plant to which the utility is committed as of the date the qualifying facility offers to accept capacity credits based on that particular plant." The PUC states that the only item required by its regulations is an offer of acceptance, *not* a "legally enforceable obligation". The Commission then presents synopses of twelve cases in which it consistently has applied and refined its "serious negotiations" standard in accordance with the "offer of acceptance" provision of the regulations.

In distinguishing "offer of acceptance" from "legally enforceable obligation" and stating that the latter is not required in Pennsylvania, the PUC essentially admits that its practice contravenes the FERC regulations. The fact that the PUC's practice has been consistent does not make that practice legal.

The PUC also suggests that even if it had established rates in excess of FERC's definition of FAC, its action would not be preempted, citing *Consolidated Edison Co. of New York v. Public Service Commission,* 63 N.Y.2d 424, 483 N.Y.S.2d 153, 472 N.E.2d 981 (1984), *appeal dismissed,* 470 U.S. 1075 (1985). In that case the New York Court of Appeals held that a *state statute* requiring uniform rates for purchases from QFs, frequently in excess of FAC, was valid. The court relied primarily on a

statement in the Preamble to the FERC rules to the effect that states could, on the basis of their own authority, prescribe QF purchase rates higher than FAC.

Consolidated Edison is clearly distinguishable from the present case. Pennsylvania has no statute authorizing rates in excess of FAC. In fact, Pennsylvania's most nearly relevant statute directs the PUC to require utility rates to the public that reflect savings to the utility from cogeneration. 66 Pa. C.S. § 527. That statute serves as evidence that the Pennsylvania legislature has not purported to grant the PUC authority to prescribe or approve rates for utility purchases from QFs in excess of FAC. Because there is no state law on this point, the issue is not one of preemption; the issue here is whether the PUC has exceeded the bounds of the federal authority delegated to it under PURPA.

Courts in other jurisdictions have considered the issue of the meaning of the phrase "legally enforceable obligation" in FERC's rules. In *Snow Mountain Pine Co. v. Mauldin*, 84 Or. App. 590, 734 P.2d 1366, *review denied*, 303 Or. 591, 639 P.2d 571 (1987), a prospective cogenerator presented a contract to a utility with rates based on the utility's avoided cost schedule then on file with the state public utility commissioner. The utility said it would agree to the contract rate only if the commissioner would permit the utility to pass the rate through to its customers. Negotiations broke down at that point, and the QF filed a complaint with the commissioner seeking to compel the utility to purchase. The commissioner held that the utility had an obligation to purchase as of the date of his order, with rates to be calculated from a later avoided cost filing. Oregon had enacted legislation closely paralleling PURPA, and the commissioner had prescribed administrative rules substantively the same as FERC's regulations.

The Court of Appeals of Oregon first noted that the utility's obligation to purchase QF power was not gov-

erned by common law concepts of contract law—the obligation was imposed on the utility by statutes, regulations and rules rather than being voluntarily assumed. Interpreting both 18 C.F.R. § 292.304(d) and the comparable Oregon rule, the court noted that the legally enforceable "obligation" is the QF's obligation to provide energy, and the "time the obligation is incurred" refers to the date on which a binding obligation to deliver energy exists.

> Thus, the regulations and administrative rules contemplate that a qualifying facility's self-imposed obligation *to deliver energy* trigger's a utility's obligation *to purchase energy*. The date on which the qualifying facility obligates itself to deliver energy fixes the date on which the 'avoided costs' are determined.

Snow Mountain Pine, 84 Or. App. at 599, 734 P.2d at 1371. After citing the FERC Preamble language stating that use of the term "legally enforceable obligation" was intended to prevent a utility from circumventing its duty to provide the proper capacity credit simply by refusing to enter into a contract, the court held, "We conclude that a qualifying facility has the power to determine the date for which 'avoided costs' are to be calculated by tendering an agreement that obligates it to provide power." *Id.* at 600, 734 P.2d at 1371.

Similarly, in *Appeal of Public Service Co. of New Hampshire*, 130 N.H. 285, 292, 539 A.2d 275, 279 (1988), the Supreme Court of New Hampshire held:

> The PUC's articulated policy is to treat the filing of a rate petition accompanied by an interconnection agreement signed by the small power producer as a legally enforceable obligation. This is consistent with subsection (ii) of 18 C.F.R. § 292.304 (d)(2).[10]

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[10] *See also In re Inter-Power of New York, Inc.*, 79 Md. P.S.C. 279 (1988). That case involved a complaint by a QF against the parent of West Penn, Allegheny Power System, Inc., and a corporate sister

These cases are sensible and persuasive. Where a QF has entered into a contract with a utility, the QF has a legally enforceable obligation to deliver power. Where a QF has done everything within its power to create such an obligation, either by tendering a contract to the utility or by petitioning the PUC to approve a contract or to compel a purchase, and only an act of acceptance by the utility or an act of approval by the PUC remains to establish the existence of a "contract", then the "legally enforceable obligation" contemplated by § 292.304 (d)(2) has been created, and the QF is entitled to rates based on avoided costs calculated from the date of the QF's action.

However, the "legally enforceable obligation" we have just described does *not* exist at a time during "serious negotiations" between the parties (whether at the time of agreement in principle on price or otherwise) when the QF has not yet obligated itself to deliver power and remains free to walk away from the negotiations without liability. In implementing its serious negotiations standard, the PUC has contravened the specific provisions of 18 C.F.R. § 292.304(d), and its policy must be classified as an error of law. In the name of implementing the FERC regulations, the PUC may not adopt a policy that is contrary to those regulations.

The policy reason that gave rise to the PUC's practice of permitting QFs to lock in rates as of the time of serious negotiations is that most cogeneration or small power production projects are project financed, and the early determination of the stream of income facilitates

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of West Penn, the Potomac Edison Company. The QF sought to prevent the utility from withdrawing price offers that it had made in letters very similar to the original written offers from West Penn in this case, arguing that a "legally enforceable obligation" under § 292.304(d)(2) had been created. The Maryland Public Service Commission rejected the QF's argument, noting that the QF itself admitted that the parties were still in the process of negotiating.

arranging the financing. That is a serious concern; however, such policy considerations may not overcome a contrary result required by law. Furthermore, we believe that the FERC regulations and commentary noted above express a policy of their own. In PURPA Congress conferred an extraordinary benefit on QFs in service of the overall goal of reducing the nation's dependence on unreliable energy sources. QFs may compel utilities to purchase the power they produce, and at a very good price. The FERC regulations and commentary imply that FERC made a deliberate choice not to confer the benefit of capacity credits until a QF was willing and able to make a commitment to deliver power and actually made such a commitment.

Armco/Allegheny also contends that the PUC's order is invalid for failure to consider the many factors that a PUC must consider, to the extent practicable, when setting utility rates for purchases from QFs, as listed in 18 C.F.R. § 292.304(e). As mentioned above, the PUC has prescribed by regulation a method of calculating FAC and capacity credits that it believes satisfies the requirements of the FERC regulations. In this case the PUC employed a method proposed by West Penn that, the parties agreed, provided an accurate assessment of FAC while yielding lower results than the Commission's method. However, Armco/Allegheny did not challenge the West Penn method before the Commission but rather objected to certain specific inputs. Hence, Armco/Allegheny cannot be heard to complain here for the first time that the necessary factors were not considered.

Phase Two—New EEPA Issues

On the Phase Two issues relating to the Milesburg Project, the PUC reversed the ALJ. The Commission agreed with the ALJ that MEI's EEPA had lapsed, rendering modification of that contract under § 508 of the Public Utility Code a moot point, but the Commission stated:

> Nevertheless, Milesburg has been endeavoring to obtain an approved power purchase agreement with West Penn since 1986. Although West Penn does not have a legally enforceable obligation to purchase power under the lapsed 1987 EEPA, it does have a legally enforceable obligation under PURPA 210 to purchase Milesburg's power at rates determined in accordance with West Penn's avoided cost projections in effect in 1986. The Commission has the responsibility to enforce the provisions of PURPA 210 in Pennsylvania. Milesburg has requested rates based on West Penn's methodology, which we have determined to be the appropriate benchmark of avoided costs in these proceedings. Milesburg has done nothing to waive its entitlement to rates based on avoided costs as of the time of serious negotiations. Therefore, it is our responsibility to require West Penn to enter into a new EEPA with Milesburg, identical in terms with the lapsed EEPA, with extensions to the millstone [sic] dates and revised capacity rates that reflect the Project's later in-service date. Specifically, we will require a financing closing date six months after the issuance of a final nonappealable Order, with similar extensions to related milestones.
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> —— Pa. P.U.C. ——, ——, 106 PUR 4th 459, 481 (1989).

The PUC ordered that the capacity rate in the new contract reflect the later in-service date of the Milesburg Project and ordered that the Consent Order adopted by the PUC on September 1, 1988, be interpreted as requiring MEI not to seek a capacity rate increase for the six months that it was in effect. Therefore, six months would be deducted from the previously anticipated financing and construction period of thirty-six to forty-two months to arrive at a new in-service date of thirty months after a final order, for the purpose of calculating the new

capacity credit. The PUC approved the ALJ's recommendation revising the West Penn method of calculating FAC to reflect monthly rather than yearly payments to the QF, which results in a slightly lower capacity credit. The Commission rejected the ALJ's suggestion that MEI should be required to seek a new evidentiary proceeding, because such a requirement probably would kill this project and would give substantive effect to regulatory litigation delays. The PUC agreed with the ALJ that the bill insert notice already provided before the hearing in these proceedings was adequate, despite requested modifications to the capacity rate in the course of the proceedings.

Our analysis of the Phase Two issues is informed by our discussion of the Phase One issues, principally, by the points that a negotiated contract conditioned on PUC approval is *not* the privately negotiated contract contemplated by 18 C.F.R. § 292.301, and that FERC has granted state PUCs broad authority to accomplish the purposes of § 210 of PURPA, so long as their actions are consistent with the FERC regulations. We note that no party has challenged the fundamental principle that a PUC has the power to order a utility to enter into a contract with a QF.

As noted by the court in *Stone Mountain Pine Co.*:

> [The utility's] obligation is not governed by common law concepts of contract law; it is created by statutes, regulations and administrative rules. . . . Thus, the obligation to purchase power is imposed by law on a utility; it is not voluntarily assumed.

84 Or. App. at 598-99, 734 P.2d at 1370.

A utility's submission of its contract with a QF to the PUC for approval is legally equivalent to a petition by the QF to the PUC to compel the utility to enter into that contract. In our view, such a petition necessarily invokes the full power and duty of the PUC to examine all of the contract's terms and conditions to ensure that they are in

compliance with the FERC regulations implementing PURPA. This principle applies to terms relating to milestone dates as well as terms relating to price. The situation is not significantly different from one where a QF simply petitions the PUC to compel a utility to purchase. The PUC must order a rate for such a purchase equivalent to the full avoided costs, 18 C.F.R. § 292.304 (b)(2), and the PUC may not order terms or conditions for the purchase in any way contrary to the FERC regulations, or contrary to the goals of PURPA.

The question underlying most of the Phase Two issues is the degree to which a QF has the power to bargain away the rights and advantages conferred on it by PURPA, or, conversely, the extent of the power of the PUC to rescue a QF from a bad bargain. Where a utility privately negotiates and executes a contract with a QF, the parties may agree to virtually anything, and the terms of their agreement are legal and enforceable. However, when the utility chooses not to accept the risk that rates it has negotiated will be proper and recoverable, but conditions its obligations on preapproval by the PUC, then the utility subjects the entire agreement to the scrutiny of the PUC and incurs the risk that the PUC may modify other provisions of the contract if it concludes that they are not in accordance with PURPA and the FERC regulations.

In the present case, the PUC has handled the problems created by the expiration of a milestone date in a submitted contract, due to litigation delays, by giving effect to that expiration, but then ordering the utility to enter into a new contract, substantially identical to the old one, but with adjustments to the capacity rates reflecting the effects of the delay. The Commission's action is equivalent to treating the submission of the contract by the utility as a petition by the QF, and then declining to approve a rigid milestone provision in the contract that would have the effect of allowing regulatory litigation

delay to kill this otherwise acceptable and desirable project. As the PUC's opinion indicates, the power it exercised was its federally delegated power under PURPA. That power is different from the PUC's power under the state Public Utility Code, and it is not constrained by the provisions of state law.

West Penn first raises a procedural challenge to the PUC's ordering it to enter into the new EEPA with MEI, arguing, on the basis of *Milesburg I*, that the Commission was required to provide ratepayers notice and a hearing before it issued such an order. Unlike the contract approval at issue in *Milesburg I*, the order under review here did not spring full-grown from the head of the PUC. As the description of the history of this case and the analysis above indicate, the Commission's order was in response to the original petition for approval of the EEPA, and it was entered only after an ALJ conducted an exhaustive hearing preceded by bill-insert notice. Having provided notice and a hearing with regard to the overall proceeding, the Commission satisfied the requirements of *Milesburg I*.

West Penn next asserts that the PUC committed an abuse of discretion in ordering it into a contract with indefinite milestone dates, because fixed milestones are necessary for the protection of West Penn's ability to conduct orderly capacity planning. The PUC and MEI respond that the milestone extensions are not as open-ended as West Penn suggests; when these proceedings finally end, the milestone dates will be fixed. By requiring a financing closing date six months after the issuance of a final nonappealable order, with similar extensions to related milestones, the PUC has retained the sensible protections afforded to the utility by the use of milestone dates, but it has eliminated the effect of regulatory litigation delays. In our view, the PUC has full discretion in the exercise of its powers under PURPA and the FERC regulations to encourage the development of cogeneration and small power production to ensure that litigation de-

lays do not become the factor that determines whether a project proceeds or fails.

Armco/Allegheny challenges here the propriety of the Commission's ordering the capacity rate in the new EEPA to be based on the later in-service date for this project, arguing that a just and reasonable capacity rate cannot be developed by selectively choosing input assumptions over a multi-year period. The Commission's holding on this point was as follows:

> With respect to the capacity rates, we find no inconsistency with reflecting the Project's later in-service date in the calculation under West Penn's methodology. All of the inputs regarding West Penn's avoided costs will remain the same. The in-service date is not a component of West Penn's avoided costs, or the cost of the 300 MW coal unit, but a component in the calculation of the QF's ability to defer or avoid West Penn's projected costs. West Penn's avoided *costs* do not change with changes in a Project's in-service date. Rather, a change in the in-service date changes the capacity *credit* while keeping West Penn's avoided *costs* constant.

—— Pa. P.U.C. at ——, 106 PUR 4th at 481. The PUC is correct on this point. Had the parties originally anticipated an in-service date as late as the one that will now occur, the capacity credit would have been higher to reflect the closer match to the actual capacity needs of the utility. The PUC's accounting for that fact is simply one aspect of its efforts to approve a contract that has not been altered to the detriment of the QF by the delays resulting from this litigation.

Finally, both Armco/Allegheny and West Penn contend that the PUC erred by failing to hold that the Consent Agreement entered into by the parties and adopted by the Commission on September 1, 1988, bars any increase in the capacity rate that MEI will receive. West Penn stresses the common law contract interpretation prin-

ciple that an agreement that is clear on its face should not be rewritten by courts or agencies. Armco/Allegheny complains that the PUC's interpretation of the Consent Agreement was completely novel, not having been advanced by any party.

The PUC's arguments, that the Consent Agreement lapsed along with the original contract or that the Commission's interpretation is justified because its staff was involved in the negotiations that led to the agreement, are not persuasive. Nevertheless, the PUC's decision was within its discretion. Had the parties privately negotiated and executed a contract, common law principles would apply. Because they do not, the PUC must be guided by the overriding concern of implementing the policies of PURPA in its treatment of the relationship between them. Where the PUC has the power under PURPA and the FERC regulations to order the execution of a new contract after the previous one expired, then it certainly has the power to withhold ongoing effect from the QF's agreement not to seek a capacity increase to which it might otherwise be entitled.

Conclusion

Our scope of review of PUC adjudications is limited to determining whether constitutional rights were violated, an error of law committed or a finding of fact was not supported by substantial evidence. 2 Pa. C.S. § 704; *T.W. Phillips Gas and Oil Co. v. Pennsylvania Public Utility Commission*, 81 Pa. Commonwealth Ct. 205, 208, 474 A.2d 355, 358 (1984).

On the Phase One issues in this case we have concluded that the PUC erred as a matter of law in applying a "time of serious negotiations" standard for determining at what point the avoided costs of a utility should be calculated. Accordingly, we shall reverse on this point and remand to the Commission with instructions that the PUC calculate MEI's capacity cost credit according to West Penn's method, using inputs appropriate for the time when West Penn and MEI executed their contract.

No party has challenged the Commission's approval of a modification to West Penn's method to account for monthly payments to the QF, and that modification should be employed in the calculation. The PUC must produce a calculation that is binding upon it, and it must make that calculation part of the record of this proceeding. If the calculated capacity credit is lower than the rate to which Milesburg previously agreed, the PUC must offer Milesburg the opportunity to decline to proceed with the project. The PUC need not provide another hearing with reference to the calculation ordered here. For due process reasons, however, the PUC must communicate its results to the parties and permit the submission of written objections, should any party wish to challenge the accuracy of the calculation.

On the Phase Two issues, the PUC properly exercised its authority under the FERC regulations implementing PURPA to order West Penn to enter into a contract with MEI identical to the one the parties originally negotiated, but with the adjustment noted above for monthly payments, and with extensions to the milestone dates. Because we also approve the PUC's ordering calculation of a capacity credit reflecting an in-service date thirty months after the entry of a final nonappealable order by the Commission, and the calculation ordered above should incorporate that input, we affirm the PUC's decision on these points.

Finally, we note that this case involves a question of first impression, the resolution of which could not have been clearly foreshadowed. Accordingly, our intention is that the decision shall have only prospective effect. *Chevron Oil Co. v. Huson,* 404 U.S. 97 (1971).

/s/ David W. Craig
DAVID W. CRAIG
Judge

Former President Judge Crumlish did not participate in the decision in this case.

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

No. 2092 C.D. 1989

ARMCO ADVANCED MATERIALS CORPORATION and ALLEGHENY LUDLUM CORPORATION,
Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

ORDER

NOW, July 17, 1990, the Order of the Pennsylvania Public Utility Commission at Docket No. P-870216, entered September 29, 1989, is affirmed in part and modified in part. The order is modified so that the direction to West Penn Power Company to enter into an Electric Energy Purchase Agreement with Milesburg Energy, Inc., with terms and conditions identical to the 1987 EEPA between the parties, shall provide that calculation of the capacity cost credit shall relate to factors in existence at the time the EEPA was signed, February 25, 1987, rather than as of the time of serious negotiations between the parties. The order is affirmed in all other respects.

This case is remanded to the Commission with instructions for the Commission to make a new calculation of the capacity cost credit, according to the method of calculation employed by West Penn through these proceedings, with the adjustment for monthly rather than yearly payments noted in the Commission's opinion. Such calculation shall use inputs appropriate for February 25, 1987, but with an in-service date thirty months from the time that the Commission's order becomes final and non-

appealable. In addition, the financing closing date shall be six months from the time that the Commission's order becomes final and nonappealable, and other milestone dates shall be adjusted accordingly. The Commission shall make its calculation part of the record of this proceeding, and it shall supply copies to the parties, allowing a reasonable period for the submission of written objections to the calculation. Should the new capacity rate prove to be less than that to which the parties initially agreed, the PUC shall offer Milesburg Energy, Inc. the opportunity to decline to proceed with the project.

Jurisdiction relinquished.

/s/ David W. Craig
DAVID W. CRAIG
Judge

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

No. 2074 C.D. 1989

WEST PENN POWER COMPANY,
Petitioner

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

ORDER

NOW, July 17, 1990, the Order of the Pennsylvania Public Utility Commission at Docket No. P-870216, entered September 29, 1989, is affirmed in part and modified in part. The order is modified so that the direction to West Penn Power Company to enter into an Electric Energy Purchase Agreement with Milesburg Energy, Inc., with terms and conditions identical to the 1987 EEPA between the parties, shall provide that calculation of the capacity cost credit shall relate to factors in existence at the time the EEPA was signed, February 25, 1987, rather than as of the time of serious negotiations between the parties. The order is affirmed in all other respects.

This case is remanded to the Commission with instructions for the Commission to make a new calculation of the capacity cost credit, according to the method of calculation employed by West Penn through these proceedings, with the adjustment for monthly rather than yearly payments noted in the Commission's opinion. Such calculation shall use inputs appropriate for February 25, 1987, but with an in-service date thirty months from the time that the Commission's order becomes final and non-appealable. In addition, the financing closing date shall

be six months from the time that the Commission's order becomes final and nonappealable, and other milestone dates shall be adjusted accordingly. The Commission shall make its calculation part of the record of this proceeding, and it shall supply copies to the parties, allowing a reasonable period for the submission of written objections to the calculation. Should the new capacity rate prove to be less than that to which the parties initially agreed, the PUC shall offer Milesburg Energy, Inc. the opportunity to decline to proceed with the project.

Jurisdiction relinquished.

/s/ David W. Craig
DAVID W. CRAIG
Judge

APPENDIX C

IN THE COMMONWEALTH COURT
OF PENNSYLVANIA

No. 2092 C. D. 1989

ARMCO ADVANCED MATERIALS CORPORATION and
ALLEGHENY LUDLUM CORPORATION,
Petitioners

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

No. 2074 C. D. 1989

WEST PENN POWER COMPANY,
Petitioner

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent

ORDER

NOW, September 13, 1990, having considered the application for reargument filed by petitioner West Penn Power Company and answers of respondent PUC, petitioner Armco/Allegheny and intervenor Milesburg Energy, Inc., the application is denied.

BY THE COURT:

/s/ David W. Craig
P. J.

APPENDIX D

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held September 17, 1987

Commissioners Present: Bill Shane, Chairman
Linda C. Taliaferro
Frank Fischl
William H. Smith

Docket No. P-870216

PETITION OF WEST PENN POWER COMPANY
Re MILESBURG ENERGY, INC.

ORDER

BY THE COMMISSION:

On February 25, 1987, West Penn Power Company ("West Penn") entered into an agreement with Milesburg Energy, Inc. ("MEI") for the purchase of power from a 43 MW electrical generating facility to be owned and operated by MEI in Milesburg, Centre County, Pennsylvania. The facility, originally West Penn's Milesburg Power Station, was permanently retired from service pursuant to Commission Order entered May 23, 1983 at P-830434. The Milesburg facility will be purchased from West Penn by MEI, and will be modified so as to burn bituminous coal waste. The West Penn/MEI contract is for a 30-year term with energy production to commence on or before March 31, 1990. As a condition precedent

to the contract, the Milesburg facility must be certified by the FERC as a Small Power Production Facility under provisions of Section 210 of the Public Utility Regulatory Policies Act, 16 U.S.C. § 824a-3(a)-(j), and regulations promulgated thereunder at 18 C.F.R. §§ 292.101, *et seq.*

Pursuant to the Public Utility Regulatory Policies Act ("PURPA"), FERC regulations and Commission regulations at 52 Pa. Code §§ 57.31-57.39, West Penn is required to purchase power generated by MEI, and taken together these authorities require that such purchases be made at a price equivalent to or below the full avoided cost incurred by the utility in buying or producing the energy itself. These authorities also expressly authorize the PURPA qualifying facility ("QF") the benefit of arrangements which provide for "levelized" payments, even though payments at times (particularly during the early years of the power purchase contract) may exceed the utility's full avoided cost. *See: Petition of West Penn Power Company Re Allegheny Lock and Dam No. 5*, Order entered January 2, 1987 at P-860165.

Under the terms of the West Penn/MEI contract, West Penn has agreed to purchase all electrical energy and capacity produced by MEI. West Penn will pay a variable-rate energy cost established in the contract and based upon the utility's actual production costs. The energy cost, as set forth in Section 1.2 of the contract, is an adjustable rate equal to West Penn's "Avoided Energy Cost Rate" as defined in the West Penn/MEI agreement; specifically, energy charges under the contract are based upon the actual monthly experienced energy costs of "Proxy Units" within the Allegheny Power System ("APS"), in which West Penn is a member utility. MEI will receive a levelized capacity payment of $0.033 per Kwh, representing West Penn's calculation of the levelized present value of avoided capacity over the 30-year term of the contract.

The agreement further provides that MEI is responsible for the construction, ownership and maintenance of the facility, subject to extensive approval and oversight by West Penn. The facility is located within West Penn's service territory and power generated by MEI will be delivered by direct interconnection with the West Penn's system. The utility will be responsible for construction and maintenance of all interconnection equipment, although it will be compensated by MEI for all costs and expenses incurred. Inasmuch as the agreement involves direct capacity charges, the contract includes at Sections 3.8 and 3.7, respectively, both reserve fund and business interruption insurance provisions. The West Penn/MEI contract also includes, at Section 6.2, substantial penalty provisions subjecting MEI to "Capacity Replacement Charges" if the Milesburg facility fails to meet contractual generating requirements.

By the instant petition filed April 2, 1987, West Penn seeks advance approval for recovery through its energy cost rate ("ECR") mechanism of all energy and capacity costs incurred under the contract; submitted along with the petition, pursuant to 52 Pa. Code § 57.32(c)(2), was a copy of the MEI contract. Advance ratemaking approval as requested is specified under Section 5.3 of the West Penn/MEI agreement as a condition precedent to the contract. Section 5.3 also specifies as a condition precedent express Commission ruling that the addition of the Milesburg capacity will not result in an excess capacity ratemaking adjustment pursuant to 66 Pa. C.S. § 1323.

On April 21, 1987, the Office of Trial Staff ("OTS") filed an answer to West Penn's petition. OTS states that while the MEI contract may be reasonable and in the public interest, the advance ratemaking approval sought violates procedural due proces rights of parties to future rate proceedings, and therefore should be denied. OTS avers that such advance guarantee of recovery denies in-

terested parties the opportunity to challenge the justness and reasonableness of the MEI expense at such time as it is proposed for recovery through West Penn's ECR, and that the Commission should not grant substantive approval of the proposed rates in the absence of due process notice and full opportunity for hearing. OTS also questioned the propriety of the levelized capacity charge under the contract.

In addition to the OTS pleading, on April 22, 1987, the Office of Consumer Advocate ("OCA") answered the West Penn petition, and on May 1, 1987, Armco, Inc. and Allegheny Ludlum Corporation filed, jointly, to intervene and to dismiss the West Penn petition. In its answer, the OCA stated that while the West Penn/MEI agreement appeared reasonable and in the public interest, the proposal for Commission interpretation of 66 Pa. C.S. § 1323 in the context of the petition was inappropriate. The joint motion to dismiss charged that West Penn had failed to obtain necessary certification from the Commission for sale of the Milesburg Power Station facility, and alleged that the requested declaration regarding excess capacity was improper since the express statutory exemption for cogeneration facilities in a Section 1323 excess capacity calculation is inapplicable.

MEI intervened in support of the West Penn petition, and along with West Penn filed response to the OTS, OCA and Armco/Allegheny Ludlum pleadings.

Considering the merits of West Penn's April 2, 1987 petition, the Commission notes, as observed in the OCA's answer, that the West Penn/MEI contract involves a project which is environmentally and socially beneficial, and that since the project involves the rehabilitation and use of an out-of-service generating station converted to burn bituminous coal refuse, it appears to present positive benefits to the Milesburg area and to Pennsylvania as a whole. The Milesburg project not only represents the wise use of Pennsylvania resources, but will create jobs

and will provide West Penn ratepayers with a source of energy over the 30-year anticipated life of the project more cheaply than it can otherwise be produced or acquired by the utility.

Additionally, under the West Penn/MEI contract, the QF assumes basically all risks associated with the construction and operation of the generating plant. If the project is not developed, all amounts spent in furtherance of construction are absorbed by MEI; West Penn ratepayers are not liable. If the facility experiences forced outages, MEI absorbs the carrying charges, including debt payments, associated with the facility. The contract contains provisions designed to assure West Penn that energy and capacity will be available on a reasonably continuous basis throughout the term of the agreement, and provides protections under Sections 3.7, 3.8 and 6.2 if such capacity is not continually available. Moreover, to protect its interest in the contract, West Penn will retain a mortgage and security interest in all real and tangible personal property of MEI associated with the facility, subject only to liens securing MEI project debt or otherwise approved by West Penn.

Capacity cost calculations pursuant to the Commission's PURPA Section 210 regulations (52 Pa. Code §§ 57.31, *et seq.*) show a levelized capacity cost of $0.0476 per Kwh for West Penn. The $0.033 per Kwh capacity rate under the contract is West Penn's estimate of its levelized present value of avoided capacity over the life of the Milesburg project as of May 27, 1986. West Penn has been advised by MEI that the levelized capacity payments are necessary for financing the project—the levelization of capacity costs provides MEI with up front revenues sufficient to cover anticipated debt service, as well as operation and maintenance expenses, during the initial period of the agreement. Although initial revenues to MEI are at a rate higher than West Penn's current actual avoided cost (the Milesburg capacity not estimated

as being needed until 1995), over the life of the project, the present value of the capacity payments to MEI is well below West Penn's calculated value of the capacity assumed to be delayed or avoided.

With the addition of the Milesburg capacity, West Penn's reserve margin through 1996 does not appear to be at a level in excess of that reasonably necessary to assure the continuation of adequate, safe and reliable service, and assuming approval of the MEI contract, the utility will defer for a least a period of two years planned construction of additional base-load generation presently scheduled to go on line in 1995. Moreover, based upon West Penn's avoided cost filing of July 31, 1986, Commission cost-benefit analysis suggests that over the entire 30-year life of the Milesburg project, ratepayers will experience a total savings of some $34 million on a net present value basis.

With regard to the procedural issues raised by OTS, it is noted that Commission regulations at 52 Pa. Code § 57.32(c)(2) require the filing of any contract between a utility and QF having a design capacity in excess of 500 Kw. Ratemaking approval for recovery of costs incurred pursuant to such contracts is not required, however, and neither federal law or regulations nor state law or regulations mandate Commission approval of the terms and conditions of an agreement between the utility and QF. Nevertheless, utilities have consistently sought Commission assurances that costs incurred for power purchased from QF's will be recoverable from ratepayers. In the instant case, West Penn similarly demands preapproval through the incorporation of a specific condition precedent in the MEI contract, and additionally seeks a protective interpretation of 66 Pa. C.S. § 1323 vis-a-vis the Milesburg project.

As fully noted in the recent Order entered July 8, 1987 at P-870214 (*Petition of Philadelphia Electric Company Re Geological Reclamation Operations and Waste*

Systems, Inc.), the Commission has historically granted advance ratemaking approval of amounts paid to QF's under contract as West Penn has requested. The rationale for such approval was fully addressed in that order, and will not be repeated here. As the Commission has stated previously, given the public interest in the contract, the extensive Commission precedent for ratemaking preapproval as requested, and the fact that the legal issues will be fully aired at I-860025, the generic investigation of the Commission's PURPA Section 210 regulations, the Commission considers it both appropriate and in the public interest to grant the ECR ratemaking preapproval requested in West Penn's April 2, 1987 petition for declaratory order. Moreover, for the Commission to disapprove the instant agreement due to the procedural concerns raised by OTS could potentially stifle PURPA 210 small power production in Pennsylvania.

In their motion to dismiss, Armco, Inc. and Allegheny Ludlum Corporation aver that under 66 Pa. C.S. § 1102 a Certificate of Public Convenience is required for West Penn's sale of the Milesburg plant. As correctly pointed out in the answer filed by West Penn, the reasoning in the motion is clearly flawed. By Order entered May 23, 1983 at P-830434, this Commission removed the Milesburg Power Station from West Penn's rate base. In view of the extensive public interest review incident to abandonment of the Milesburg Power Station, it is unnecessary for the utility to obtain a separate Certificate pursuant to 66 Pa. C.S. § 1102(a)(3) for the sale to MEI.

As for the argument in the motion to dismiss regarding interpretation of 66 Pa. C.S. § 1323(c), a more detailed analysis is required. Section 1323 provides, in pertinent part, as follows:

> § 1323. Procedures for new electric generating capacity.
>
> (a) Excess capacity costs.—Whenever a public utility claims the cost of an electric generating unit

in its rates for the first time and the commission finds that the unit results in the utility having excess capacity, the commission shall disallow from the utility's rates, in the same proportion as found to be excess capacity:

(1) the return on specific unit or units of any excess generating reserve;

(2) the return on the average net original cost per megawatt of the utility's generating capacity; or

(3) the equity investment in the new unit.

In addition to the disallowances set forth in this subsection, the commission may disallow any other costs of the unit or units which the commission deems appropriate. For the purposes of this section, a rebuttable presumption is created that a unit or units or portion thereof shall be determined to be excess unless found to be needed to meet the utility's customer demand plus a reasonable reserve margin in the test year or the year following the test year, or, if it is a base load unit, it is also found to produce annual economic benefits which will exceed the total annual cost of the plant during the test year or within a reasonable period following the test year.

* * * *

(c) Other powers and duties preserved.—This section shall not be construed to diminish the powers and duties of the commission under any other provision of law to reduce rates because of excess capacity or any other reason, provided that, in determining whether a base load unit, which was in commercial operation for at least one year prior to the effective date of this section, results in a public utility having excess capacity, cogeneration, for which an agreement has been entered into by the public utility within three years after the in-service date of the base load unit, shall not be considered by the

> commission in determining the reserve margins or economic benefits resulting from the base load unit for the first five years after the date of the cogeneration agreement.

Armco, Inc. and Allegheny Ludlum Corporation would interpret this section narrowly to hold that the Commission is expressly without authority to order that the MEI capacity should not be included in any subsequent calculation of excess generating capacity. Section 1323 is clearly not so restrictive.

What is expressly provided in Section 1323 is, first, that the Commission can make rate base adjustments to reflect a utility's excess capacity, and second, that with regard to such adjustment for a base load plant in service prior to July 10, 1985 (one year prior to the July 10, 1986 effective date of Section 1323), the Commission may not include, for a period of five years, any consideration of PURPA 210 capacity which is under contract with the utility within three years of the in-service date of that base load plant.

With specific reference to West Penn's Bath County base load facility, as stated in the motion to dismiss, it is clear that the pumped storage plant was not in commercial operation prior to July 10, 1985 (the actual in-service dates being December 18 and 31, 1985). As such, the Commission is not statutorily precluded from including the MEI capacity in an adjudication as to whether the Bath County project constitutes excess generating capacity. By the same token, however, Section 1323 does not estop the Commission from granting the relief requested in West Penn's petition. Contrary to arguments by Armco, Inc. and Allegheny Ludlum Corporation, the General Assembly has not mandated the inclusion of PURPA 210 generating capacity in those cases where the capacity is not expressly to be excluded. In fact, legislation at 66 Pa. C.S. § 523(b)(4) specifically directs that the Commission encourage the development of cogeneration and small

power production, and that utilities failing to cooperate be subject to ratemaking penalty.

In its petition, West Penn has averred that without an express Commission finding that the Milesburg capacity will not be considered in any base rate excess capacity determination under Section 1323, the utility will not enter into the MEI contract, or any other PURPA 210 agreement. Consistent with the Commission's current thinking as expressed in the proposed "Policy Statement on the Treatment of Qualifying Facilities in Excess Capacity Determinations" published for comment on July 18, 1987 at 17 Pa.B. 3035, it is proper that the relief requested by West Penn be granted. In the proposed statement of policy, the Commission held that in most cases it is both appropriate and consistent with the legislative intent to exclude QF capacity in excess capacity/reserve calculations pursuant to Section 1323—the exception being where a utility purchases long-term QF capacity and subsequently fails to defer or cancel planned construction of its own generation.

Although the Commission herein concludes that capacity represented by the Milesburg project should not be included in any calculation of excess capacity for purposes of a ratemaking adjustment pursuant to 66 Pa. C.S. § 1323, it must be noted that such approval may not necessarily be extended to future PURPA 210 projects in which West Penn may became involved. While the Commission expressly approves the West Penn/MEI agreement and the relief requested via the instant petition, it is important to note that West Penn's capacity reserve has clearly reached a point such that any additional capacity from QF's, depending upon size, may well be construed as excessive. As such, West Penn and any potential PURPA 210 QF's negotiating or contemplating negotiation with West Penn should be on notice that the Commission may not be inclined to grant further relief as in the instant petition. The Commission will

scrutinize closely, on an ad hoc basis, subsequent PURPA 210 arrangements so as to determine whether capacity purchases create excess capacity for West Penn; however, it is unlikely that the Commission will again approve capacity payments to a large QF of the sort involved in the proposed MEI contract without significant and supportable change in the utility's supply and/or demand forecasts.

In conclusion, the West Penn/MEI contract has been exhaustively examined, and its terms and conditions generally appear reasonable and in the public interest. Additionally, for the reasons addressed above, the Commission considers it appropriate and in the public interest to grant the petition of West Penn with regard to both the ECR pass-through preapproval and the Section 1323 declaration regarding capacity from the Milesburg facility; THEREFORE,

IT IS ORDERED:

1. That the February 25, 1987 contract between West Penn Power Company and Milesburg Energy, Inc. be and is hereby accepted for filing pursuant to 52 Pa. Code § 57.32(c)(2).

2. That the terms of the contract, referenced in Ordering Paragraph No. 1, above, between West Penn Power Company and Milesburg Energy, Inc. be and are hereby determined to be in the public interest.

3. That West Penn Power Company be and is hereby authorized to recover through its Energy Cost Rate expenses paid to Milesburg Energy, Inc. pursuant to the contract referenced in Ordering Paragraph No. 1, above.

4. That the Commission hereby declares that additional generation capacity as a result of the contract between West Penn Power Company and Milesburg Energy, Inc., referenced in Ordering Paragraph No. 1, above, shall not be considered by the Commission in determining

the reserve margins or economic benefits resulting from any base load or other generating unit during the terms of the contract.

5. That West Penn Power Company shall notify the Commission within 60 days of the actual in-service date of the Milesburg Energy, Inc. project.

6. That a copy of this order be served upon all parties of record in the instant proceeding.

BY THE COMMISSION

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 17, 1987

ORDER ENTERED: Sep. 22, 1987

APPENDIX E

COMMONWEALTH COURT OF PENNSYLVANIA

DAVID M. BARASCH, CONSUMER ADVOCATE,
Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent.

ARMCO, INC. and ALLEGHENY LUDLUM CORPORATION,
Petitioners,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent.

WEST PENN POWER COMPANY,
Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent.

Argued May 25, 1988

Decided Aug. 22, 1988

Before CRUMLISH, Jr., President Judge, and CRAIG, DOYLE, BARRY, PALLADINO, McGINLEY and SMITH, JJ.

CRAIG, Judge.

These consolidated cases are appeals by industrial ratepayers and the Office of Consumer Advocate (OCA) from an order of the Pennsylvania Public Utility Commission (PUC or commission) that (1) approved the terms of a proposed contract for the purchase of electric power by West Penn Power Company (West Penn) from Milesburg Energy, Inc. (MEI) as being in the public interest, (2) authorized West Penn to recover payments made to MEI under the contract from its ratepayers through the mechanism of the Energy Cost Rate (ECR), and (3) declared in effect that the generating capacity West Penn would acquire under the contract should not be considered by the commission in excess capacity determinations regarding West Penn during the term of the contract. West Penn itself appeals the PUC's refusal to publish the order in the *Pennsylvania Bulletin*.

West Penn's proposed purchase of power from MEI is covered by the federal Public Utility Regulatory Policies Act of 1978 (PURPA).[1] The issues raised are (1) whether the procedure by which the PUC considered West Penn's petition for approval of a contract covered by PURPA respected due process rights, and (2) whether the commission's decisions (a) to disregard the generating capacity acquired by this purchase when resolving West Penn excess capacity issues in the future, and (b) to approve West Penn's payment of levelized capacity charges under the contract, violated the prohibition in the Public Utility Code against rate recovery of costs for capacity that is excess.

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[1] Pub.L. No. 95-617, 92 Stat. 3117 (1978), codified primarily in 16 U.S.C. §§ 796, 791a, 823a, 824a, 824d, 824i-824k, 824(b), 824(e), 825d, 2601-2603, 2611-2644, 2701-2708 and 2645.

I. BACKGROUND

A. *Section 210 of the Public Utility Regulatory Policies Act of 1978*

Congress enacted the Public Utility Regulatory Policies Act of 1978 as part of a package of five pieces of legislation, known collectively as the National Energy Act, designed to combat the nationwide energy crisis resulting from the quadrupling of oil prices in the early 1970's and the severe shortage of natural gas in 1977. Section 210 of PURPA, 16 U.S.C. § 824a-3, is designed to lessen the dependence of electric utilities on foreign oil and on natural gas by encouraging the development of alternative power sources in the form of cogeneration and small power production facilities.

Section 201 of PURPA, 16 U.S.C. § 796(17)-(22), defines "cogeneration facility" as one that produces both electric energy and steam or some other form of useful energy, such as heat. 16 U.S.C. § 796(18)(A). The same section defines "small power production facility" as one that has a production capacity of no more than 80 megawatts and uses as a primary energy source biomass, waste, geothermal resources or renewable resources such as wind, water or solar energy to produce electric power. 16 U.S.C. § 796(17)(A).

Before PURPA, entities contemplating cogeneration or small power production faced three principal deterrents: (1) traditional electric utilities, customarily regarded and regulated by the states as natural monopolies in terms of both generation and distribution of electric power,[2] either could refuse to buy power from these nontraditional facilities, or they could offer unfairly low rates for such

[2] As PURPA clearly recognizes, and as the commentators point out, distribution of electric power may be a natural monopoly, but generation of that power is not. *See, e.g., Lock, Encouraging Decentralized Generation of Electricity: Implementation of the New Statutory Scheme,* 2 Solar L.Rep. 705, 712 (1980).

purchases; (2) traditional utilities could refuse to sell essential backup power to alternative producers of electricity, or they could charge discriminatorily high rates for such sales; and (3) the alternative producers could become subject to state and federal regulation as public utilities, giving rise to significant financial and administrative burdens that could readily offset expected savings. Section 210 of PURPA addresses each of these problems.

Section 210(a) directs the Federal Energy Regulatory Commission (FERC) to promulgate rules to encourage the development of the alternative sources of power, including rules requiring utilities to offer to buy electricity from, and to sell electricity to, qualifying cogeneration and small power production facilities (QFs). Section 210(b) directs FERC to set rates for utility purchases of power from QFs that are (1) just and reasonable to the electric consumers of the utility and in the public interest, (2) not discriminatory against QFs, and (3) not to exceed the incremental cost to the utility of alternative electric energy. Rates for utility sales to QFs are to be just and reasonable and in the public interest and not discriminatory against QFs under section 210(c). Section 210(e) directs FERC to adopt rules exempting certain QFs from most state and federal public utility regulation.

Congress chose state regulatory authorities, with their expertise and unique knowledge of local conditions, to be the primary enforcers of PURPA. Section 210(f) requires each state regulatory authority and nonregulated utility to implement FERC's rules. At the same time, section 210 and FERC's regulations give wide latitude to the state agencies in many areas in order to permit flexibility in accommodating local circumstances and to encourage experimentation in the development of this new national program.

In *Federal Energy Regulatory Commission v. Mississippi*, 456 U.S. 742, 102 S.Ct. 2126, 72 L.Ed.2d 532

(1982), the United States Supreme Court upheld section 210 as a valid exercise of Congress' power under the Commerce Clause to act in what the court previously had determined to be a fully pre-emptible field. The Court concluded that the grant of power to FERC to exempt QFs from state laws and regulations was nothing more than a form of traditional pre-emption. Further, because FERC permitted the states to implement PURPA by designating their regulatory agencies for the adjudication of disputes arising under the statute—the very type of activity customarily engaged in by these authorities—the majority held that the statute did not intrude upon state sovereignty in violation of the Tenth Amendment.

In two major rulemakings, FERC adopted regulations implementing PURPA,[3] codified at 18 C.F.R. §§ 292.101-292.602. The regulation adopted by FERC relating to purchases of power by utilities from QFs requires a rate of payment to the QFs equal to the utility's full "avoided cost" (FAC). 18 C.F.R. § 292.304(b)(2). "Avoided costs" are defined in § 292.101(b)(6) as "the incremental costs to the electric utility of electric energy or capacity[4] *or both* which, but for the purchase from the qualifying facility or qualifying facilities, such utility would

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[3] *See* 45 Fed.Reg. 12214 (February 25, 1980) *and* 45 Fed.Reg. 17959 (March 20, 1980).

[4] In the preamble to its publication of this rule, FERC noted that energy costs are the variable costs associated with the production of electric energy—the cost of fuel and some operating and maintenance expenses. Capacity costs are those associated with providing the capability to deliver energy—primarily the capital costs of facilities. FERC concluded that "[i]f a qualifying facility offers energy of sufficient reliability and with sufficient legally enforceable guarantees of deliverability to permit the purchasing electric utility to avoid the need to construct a generating unit, to build a smaller, less expensive plant, or to reduce firm power purchases from another utility, then the rates for such a purchase will be based on the avoided capacity and energy costs. 45 Fed.Reg. 12216.

generate itself or purchase from another source." (Emphasis supplied; footnote added.)[5]

FERC considered and expressly rejected proposals that the rates it prescribed pursuant to section 210 should result in some savings to utility customers. Rather, FERC preferred to allocate the full savings typically realized by the cogeneration and small power production processes to the alternative producers themselves, noting that this allocation would provide the maximum encouragement of development of these resources, and that "ratepayers and the nation as a whole will benefit from the decreased reliance on scarce fossil fuels, such as oil and gas, and the more efficient use of energy." 45 Fed.Reg. 12222.

In *American Paper Institute, Inc. v. American Electric Power Service Corporation*, 461 U.S. 402, 103 S.Ct. 1921, 76 L.Ed.2d 22 (1983), the Supreme Court upheld FERC's exercise of its authority under section 210(b) of PURPA to require a rate for utility purchases from QFs equal to the full avoided cost, that is, FERC's decision that FAC is just and reasonable to electric consumers and in the public interest. The Court determined that Congress did not intend that the phrase "just and reasonable" in section 210(b), relating to rates for *purchases* by electric utilities from QFs, be given its traditional ratemaking meaning, although Congress did intend that the same phrase be interpreted according to its traditional meaning in section 210(c), relating to *sales* by utilities to QFs. *American Paper Institute*, 461 U.S. at 414-15, 103 S.Ct. at 1928-29.[6]

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[5] The rate may be less than full avoided cost where it is based on costs of facilities whose construction was commenced before November 9, 1978, the effective date of PURPA. 18 C.F.R. § 292.304(b)(1) and (3).

[6] In a footnote, the Court observed that unless the phrase "just and reasonable" in section 210(b) of PURPA were to be regarded as mere surplusage, that language must be interpreted to mandate consideration of rate savings for consumers that could be produced by setting the rate at a level lower than the statutory ceiling, i.e.,

The regulatory scheme adopted by FERC also permits utilities and QFs to negotiate agreements for utility purchases of power independently of the prescribed rates. 18 C.F.R. § 291.301. Thus, even if a state chooses to implement the FERC regulations by adopting rules of its own prescribing a purchase rate in detail, a utility and a QF may still negotiate a different rate, using the state-prescribed rate as a baseline. Because no large utility is exempt from the FERC regulation that requires filing of detailed utility cost data and projections with the state regulatory authority, 18 C.F.R. § 292.302, a QF negotiating an agreement with a utility knows what rate it could compel if the utility failed to bargain in good faith.

Although privately negotiated contracts setting rates for QF power are essentially outside the federal and state rules, state public utility commissions have a duty to examine costs of such contracts claimed by a utility for the purpose of setting its own rates, and will disallow those found to be excessive. Therefore, the state regulatory authority plays an indirect role in the negotiating process. Utilities in Pennsylvania frequently have voluntarily sought preapproval by the PUC of the rates and terms and conditions of proposed contracts with QFs and approval of an automatic pass-through to ratepayers of the charges the utilities will pay under the contracts. Often the negotiated agreements make such advance PUC approval a condition precedent to any obligations on the part of the purchasing utility.

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lower than FAC. 461 U.S. at 415 n. 9, 103 S.Ct. at 1929 n. 9. Nevertheless, the holding of the case on this point is that FERC's adoption of FAC was proper. Because the federal oversight of the development of alternative sources of power is to be an ongoing process (section 210(a) requires FERC to adopt within one year "and from time to time thereafter revise" rules to encourage cogeneration and small power production), the Court's footnote perhaps may be best understood as a direction to FERC to monitor the effects of its rules and to reevaluate the FAC standard when the infant alternative power industry reaches a state of maturity that may require less encouragement.

The Pennsylvania Public Utility Commission, after publication of proposed regulations and extensive public comment, implemented the FERC rules by adopting regulations contained in 52 Pa.Code §§ 57.31-57.39. *See* 12 Pa.B. 4237 (December 11, 1982).

B. *Agreement between West Penn and MEI*

Under the terms of the Electric Energy Purchase Agreement between West Penn and MEI (agreement or contract), West Penn is to purchase the energy and capacity of a 43-megawatt generating unit (Milesburg project) that is to be installed by MEI at the site of the former Milesburg Power Station, which was owned and operated by West Penn and was retired from service with PUC approval in 1983. MEI is to purchase the facility from West Penn and convert it to be fueled by bituminous coal refuse, employing a circulating fluidized bed boiler technology that makes the economic burning of such waste feasible.

The agreement requires West Penn to purchase all of the capacity and energy from the Milesburg project for a period of thirty years from project completion, expected to occur in 1990. West Penn agreed to pay a variable energy charge for each kilowatt hour produced by the project at a rate equal to actual monthly experienced energy costs of "proxy units" within the Allegheny Power System, of which West Penn is a member utility. In addition, West Penn agreed to make a capacity payment of 3.3 cents per kilowatt hour, which West Penn calculated to be the levelized present value cost (at the time of the signing of the agreement) of the capacity that West Penn could avoid over the term of the contract. West Penn will make no payments to MEI until MEI actually delivers energy to West Penn.

The agreement further provides that MEI is responsible for the construction, ownership and maintenance of the facility, subject to extensive approval and oversight

by West Penn, and that MEI will compensate West Penn for the construction and maintenance of all interconnection equipment. West Penn will retain mortgage and security interests in the property of the Milesburg project. Because the agreement provides for direct capacity charges, it contains reserve fund and interruption insurance provisions as well as a provision subjecting MEI to substantial penalties if the facility fails to meet contractual generating requirements. Conditions precedent to West Penn's obligations under the agreement include certification of the Milesburg project by FERC as a qualifying facility under PURPA and the promulgation of a rule by the PUC or the existence of a PUC order, final beyond appeal, approving the legality of the agreement, published in the *Pennsylvania Bulletin.*

C. *Procedural History*

On April 2, 1987, West Penn filed a petition with the PUC requesting that the commission publish a declaratory order in the *Pennsylvania Bulletin* for public review and comment indicating that (1) unless exceptions were filed within thirty days of the date of publication, the commission would approve the agreement with MEI as complying with section 210 of PURPA and with the Public Utility Code, (2) upon the occurrence of the conditions precedent the PUC would authorize West Penn to pass the charges resulting from the agreement through to its customers by the mechanism of the Energy Cost Rate or such other method as might replace the ECR, and (3) the addition of the Milesburg project capacity would not result in an excess capacity determination under the Public Utility Code as to the MEI capacity itself or as to any existing West Penn capacity. West Penn served copies of its petition on the active parties to its most recent base rate proceeding, including Armco, Inc. and Allegheny Ludlum Corporation (Armco/Allegheny), the Office of Consumer Advocate and a

group of industrial customers identified as the West Penn Industrial Intervenors (WPII).

MEI filed a statement in support of West Penn's petition and a petition to intervene. The PUC's Office of Trial Staff (OTS) filed an answer to West Penn's petition, as did OCA. Armco/Allegheny filed, jointly, a petition to intervene and a motion to dismiss West Penn's petition or, in the alternative, a request for a hearing. West Penn filed responses to the pleadings of OTS, OCA and Armco/Allegheny, as did MEI. The commission did not hold hearings on the petition.

As discussed in n. 4, above, full avoided costs for a long-term guaranteed purchase, such as this contract will establish, include both avoided energy costs and avoided capacity costs. The commission concluded that the contract's method for calculating the energy cost component of FAC was reasonable. In addition, the commission calculated that the maximum legal capacity cost component of FAC would have been 4.67 cents per kilowatt hour. Therefore, the commission approved the contract's capacity cost credit rate of 3.3 cents per kilowatt hour.

The PUC adopted the order described above on September 17, 1987, order entered September 22, 1987, at Docket No. P-870216. The commission did not grant West Penn's request that the order be published in the *Pennsylvania Bulletin*. West Penn and Armco/Allegheny applied for reconsideration of the commission's order, and OCA filed a petition for clarification and reconsideration. By a vote of two to two at a public meeting held October 22, 1987, the commission declined to grant reconsideration. West Penn, OCA and Allegheny/Armco appealed separately from the PUC's September 22, 1987, order, and this court consolidated the appeals.

II. ISSUES AND ANALYSIS

A. PUC Procedure for Considering Utility/QF Contracts

In its petition at No. 2499 C.D. 1987, Armco/Allegheny first raises a fundamental due process challenge to the procedure by which the PUC approved the legality of the rates set forth in West Penn's contract with MEI. Armco/Allegheny avers (1) that West Penn did not give general notice to its ratepayers regarding its action in seeking PUC approval of a contract that would result in a substantial rate increase, (2) that the commission did not hold hearings permitting interested parties to present evidence and cross-examine witnesses, and (3) that the commission's order was premised on mistaken factual assumptions not contained in the record.

West Penn, in its petition at No. 2522 C.D. 1987, contends that the due process rights of its ratepayers would be protected adequately if the commission would grant West Penn's request that the commission publish its order in the *Pennsylvania Bulletin*, with the effective date of the order postponed for thirty days to allow interested parties to submit written comments.[7]

In the present case, West Penn filed with the PUC and maintained for public inspection detailed cost data reports as required by 52 Pa.Code § 57.33 (which implements the utility cost data reporting requirements of 18 C.F.R. § 292.302), including data relating to projected energy costs as well as the utility's plan for additions to

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[7] West Penn and the PUC are correct in their contention that Armco/Allegheny, because it received actual notice of West Penn's petition, is really asserting the notice rights of other persons, and it lacks standing to do so. *See, e.g., Mifflin County School District v. Monsell*, 95 Pa.Commonwealth Ct. 173, 504 A.2d 1357 (1986). However, West Penn, in its efforts to protect the commission's favorable order from future collateral attack, clearly does have standing to raise the issue of proper notice to its customers.

its plant and the estimated costs for such additions (i.e., capacity costs), all for the current year and for each of the next ten years. The PUC has made its method for calculating the capacity cost component of FAC a part of its regulations implementing PURPA. *See* 52 Pa.Code § 57.34.

Armco/Allegheny's basic due process claim is that it was not afforded an opportunity to challenge at a full hearing the details of West Penn's cost data filing, from which the commission calculated the maximum allowable capacity cost credit, or the details of the commission's factual assumptions and mathematical computations in calculating the credit.

The Pennsylvania Supreme Court has considered in depth the issue of procedural due process in the context of administrative action in a sequence of cases beginning with *Conestoga National Bank of Lancaster v. Patterson*, 442 Pa. 289, 275 A.2d 6 (1971). In *Conestoga*, banks with principal offices in a particular town challenged the action of the Department of Banking in approving the application of another bank to establish a branch office in that town without conducting a hearing on the existing banks' protests or giving those banks access to the application data. The Court observed:

> Procedural due process does not require notice and a hearing in every conceivable situation involving administrative action. . . . However, these procedural safeguards should accompany a situation where the administrative action is adjudicatory in nature and involves substantial property rights.

Conestoga, 442 Pa. at 296, 275 A.2d at 9 (citation omitted).

The Court concluded that the department's decision was adjudicatory in nature and that the decision involved substantial property rights of the applicant, the protestants and the surrounding financial community. There-

fore, the Court concluded that procedural due process required that the protesting banks be afforded notice, a hearing, the opportunity to present evidence and access to the application and supporting data concerning a proposal for a new branch. *Id.* at 299-300, 275 A.2d at 11. The Court noted, however, that the nature of banking proceedings might justify the use of proceedings of less formality than a full trial-type adversary hearing. *Id.*

In *Pennsylvania Coal Mining Association v. Insurance Department*, 471 Pa. 437, 370 A.2d 685 (1977), an association of coal mining companies challenged the statutory procedure by which rates for black lung insurance (which the companies were required by statute to purchase) were proposed by a private insurance industry group and then deemed into effect unless the Insurance Commissioner took action to disapprove or to modify them. The Court concluded that the protections of procedural due process applied to the approval of the rates in question, then stated:

> We must next determine what procedures due process requires. '[D]ue process is flexible and calls for such procedural protections as the particular situation demands.' *Morrissey v. Brewer*, 408 U.S. 471, 481, 92 S.Ct. 2593, 2600, 33 L.Ed.2d 484 (1972). See generally Friendly, Some Kind of a Hearing, 123 U.Pa.L.Rev. 1267 (1975). '[C]onsideration of what procedures due process may require under any given set of circumstances must begin with a determination of the precise nature of the government function involved as well as of the private interest that has been affected by governmental action.' *Cafeteria & Restaurant Workers v. McElroy*, 367 U.S. 886, 895, 81 S.Ct. 1743, 1748-49, 6 L.Ed.2d 1230 (1961). We must determine the private interest at stake, the value of any additional procedural safeguards, and the government's interest in proceeding without providing such safeguards.

> *Matthews v. Eldridge*, 424 U.S. 319, 96 S.Ct. 893, 47 L.Ed.2d 18 (1976).

Pennsylvania Coal, 471 Pa. at 449-50, 370 A.2d at 691.

The Court considered and rejected the proposition that the statutory provision allowing aggrieved persons to secure a full hearing before the Insurance Commissioner (with the opportunity for review by the Commonwealth Court) *after* the rates took effect [8] was adequate. Noting the preference for procedural protections *before* government action, when the citizen's burden of persuasion usually is lower and before the citizen suffers an infringement during the time required for a successful challenge, the Court held:

> Thus procedural protection should be given before government takes action which threatens to deprive a citizen of an interest, unless important governmental interests, or the preservation of the interests of others, require otherwise, See *Boddie v. Connecticut*, 401 U.S. 371, 379, 91 S.Ct. 780, 786, 28 L.Ed.2d 113 (1971).

Id. at 451-52, 370 A.2d at 692.

Under the circumstances of that case, the Court concluded that due process required that the coal companies be given notice of the rate proposals and a reasonable opportunity to present *written* reasons why the rate increases should not be allowed or why a hearing should be held before the rates became effective. The Court did not believe that due process necessarily required a full hearing, allowing for confrontation and cross-examination of witnesses: [9]

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[8] Section 654 of the Insurance Company Law of 1921, Act of May 17, 1921, *as amended*, 40 P.S. § 814.

[9] In a footnote, the court rejected the association's claim that it was entitled to a hearing before rates could become effective under section 31 of the Administrative Agency Law, Act of June 4, 1945,

> While oral proceedings may be necessary for determinations likely to turn on witness credibility, written submissions may be adequate when economic or statistical questions are at issue. See *Matthews v. Eldridge*, 424 U.S. 319, 342, 96 S.Ct. 893, 907, 47 L.Ed.2d 18 (1976); Friendly, Some Kind of a Hearing, 123 U.Pa.L.Rev. 1267, 1281-85 (1975). Moreover, unlike the opportunity to present written objections, a full hearing would entail extensive delay, during which time the insurance carriers may be deprived of their interest in receiving adequate premiums. The opportunity to recover any excessive rates paid, after proceedings pursuant to 40 P.S. § 814 (Supp. 1976), in addition to notice and an opportunity to present written objections before the rates become effective, satisfies procedural due process.

Id. at 454, 370 A.2d at 693-94.

Finally, in *Allegheny Ludlum Steel Corp. v. Pennsylvania Public Utility Commission*, 501 Pa. 71, 459 A.2d 1218 (1982), the Court upheld against a due process challenge an approval by the PUC of an increase in an electric utility's rates pursuant to section 1307 of the Public Utility Code, 66 Pa.C.S. § 1307, which provides for automatic adjustment of rates to reflect a utility's fuel cost increases (the ECR), calculated by a statutorily-prescribed formula, without a prior hearing. The Court

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P.L. 1388, formerly 71 P.S. § 1710.31, repealed by the Act of April 28, 1978, P.L. 202 (substantially reenacted and certified at 2 Pa. C.S. § 504), which provided that no adjudication of an agency would be valid as to any party unless the party was afforded reasonable notice of a hearing and an opportunity to be heard, with testimony stenographically recorded and a complete record made of the proceedings. The court noted that section 31 applied to parties, only, and that the association was not named as a party and did not have a right to intervene as a party to rate increase proceedings if the Insurance Commissioner decided to allow proposed rates to be deemed into effect without a hearing.

readily agreed that the rate increases to the complaining industrial customer, approximately $10,000 per day, constituted a substantial property interest, but the majority found a countervailing interest in the need for a public utility to receive a fair return on its property to assure its continued financial integrity and hence its abilty to provide efficient, dependable service.

The Court concluded that a combination of factors present in the statutory scheme adequately protected the due process rights of customers without providing the opportunity for a hearing before the increases at issue took effect. Chief among those factors was the provision in section 1307(e) of the statute for an automatic year-end hearing, allowing full participation by all interested parties, to determine whether ECR amounts collected by the utility during the year were "excessive" and requiring refunds (with interest calculated at the prevailing rate) for amounts determined to be such. *Allegheny Ludlum*, 501 Pa. at 77, 459 A.2d at 1221.[10] The Court noted that

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[10] The year-end proceeding appears to be designed principally for the purpose of reconciling the utility's ECR collections, made pursuant to projections, with its actual fuel expenses. *See* section 1307(e)(1), relating to the contents of reports to be filed by utilities. However, the proceeding appears to allow for the litigation of issues relating to the *propriety* of amounts collected under the ECR as well. Section 1307(c) states that the fuel cost used in computing the adjustment shall be limited to the cost of fuel delivered to a generating site at which it is to be consumed, without reference to the prudency of the fuel purchase. Nevertheless, section 1307(a) requires that the automatic adjustment "provide a just and reasonable return on the fair value of the property used and useful in the public service, to be determined upon such equitable or reasonable basis as shall provide such fair return." The provision requiring commission audits of utilities that use the ECR states that the audits "shall enable the commission to determine the *propriety* and correctness of amounts billed and collected under this section." Section 1307(d) (emphasis added). Finally, the section describing the public hearing itself states that the subject matter encompasses both the substance of the section 1307(e)(1) report *"and any matters pertaining to the use by such public utility*

the provision for a year-end hearing contrasted with the situation in *Conestoga*, where protesting banks were not afforded an opportunity to be heard either before or after the administrative determination, which was not merely provisional, but final. Further, because the PUC's power to approve an increase in ECR rates was restricted by legislative guidelines (i.e., the statutory formula for calculating ECR), the rate increases were not analogous to those proposed without public oversight by the private industry group in *Pennsylvania Coal*. Because the commission had to act affirmatively to approve the increase, the *Pennsylvania Coal* problem of rates' being deemed into effect without assurances of administrative examination was not present.

Applying analyses from these cases to the present case, we conclude, first, that substantial property interests are involved here. If the contract between West Penn and MEI provided only for payment of *energy costs*, then the contract could not have the effect of increasing customers' bills, and this case very likely would not be before us. If customers' bills do not change, they have no money at risk, and presumably they have no other interest in whether their utility pays given energy costs to a fuel supplier or to a QF.[11]

However, because of the length of the term of this contract and its legally enforceable guarantees of delivery of power, the contract provides for *capacity* payments as well as energy payments. Because West Penn will begin making capacity cost credit payments before the time

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of such automatic adjustment clause in the preceding period . . . ." Section 1307(e)(2) (emphasis added). Thus, if customers sought to challenge not the utility's projections or its computations, but rather the utility's allegedly buying more expensive fuel when less expensive fuel was available, they apparently could do so in the year-end proceeding.

[11] No party in this case has raised a claim that this contract's method for calculating energy costs is not just and reasonable.

when the capacity is actually needed, which West Penn projects to be in 1995, pass-through of these payments to West Penn's customers will result, at least in the near term, in substantial increases in their bills unrelated to their current consumption of power—a substantial property interest.[12] Additionally, even if West Penn had no contract with a QF, West Penn's customers would have a substantial property interest in assuring that future capacity charges to them for construction by West Penn itself were properly justified and calculated. We see no reason to disregard that interest because the capacity charges are to be assessed sooner rather than later.

Second, we conclude that the commission's action, in declaring that the terms of the contract are in the public interest and that West Penn may recover payments to MEI under the contract, was adjudicatory in nature. All parties to the present case recognize that the effect of the commission's order was to adjudicate rights of MEI, West Penn and West Penn's customers in relation to this contract.

Because the commission's action was adjudicatory in nature and involved substantial property rights of West Penn's customers, those customers must be afforded due process, and the question remains that of what process is due. As the cases discussed above indicate, the essential elements of due process are notice of government action and an opportunity to be heard to challenge that action, although the timing of provision of these safeguards may vary depending on circumstances.

We note first that the present situation is different from that in *Allegheny Ludlum* in one crucial respect. The commission's final approval of West Penn's recovery of payments under the MEI contract from its ratepayers means that that recovery is *not* subject to the same type

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[12] Armco/Allegheny avers that West Penn's capacity cost payments to MEI will amount to $10.56 million per year.

of year-end review provided in section 1307(e) regarding amounts the utility collects pursuant to the ECR. The commission's order here includes a declaration (i.e., a declaratory judgment) that the terms of the contract are in the public interest and that West Penn is authorized to recover its expenses under the contract from its ratepayers. That declaration approves capacity cost payments from West Penn to MEI at a rate of 3.3 cents per kilowatt hour for the entire thirty-year term of the contract. As West Penn correctly perceives, all persons with notice of the commission's action and an opportunity to be heard regarding it would be precluded from raising the issue of the legality of the contract terms or West Penn's right to recover contract expenses by West Penn in any future proceeding. Even though the commission approved recovery of these expenses through the mechanism of the ECR (because the ECR is the only method of recovery that provides a dollar-for-dollar matching of utility payments with recovery from ratepayers, *see AES Beaver Valley, Inc. v. West Penn Power Co.* (Docket No. C-844022, order entered March 13, 1985), slip op. at 12) the preclusive effect of the commission's declaration means that the year-end review provisions of section 1307(e) will not apply to this recovery, at least not to the extent of permitting challenges to the *propriety* of the 3.3 cents per kilowatt hour capacity rate. Therefore, the present situation is not analogous to that in *Allegheny Ludlum*.

Next for consideration is *Pennsylvania Coal*. The Public Utility Code contains provisions, analogous to section 654 of the Insurance Company Law of 1921, allowing any person to complain to the commission with regard to any regulation or order of the commission that the complainant is required to observe, and providing for a public hearing on such complaints, with notice and the making of a full and complete record. 66 Pa.C.S. §§ 701-703. In addition, customers' questions concerning the utility's cost data and the commission's calculation of ca-

pacity cost credit, along with the commission's underlying assumptions, are the same sort of economic and statistical issues that the Court in *Pennsylvania Coal* held to be able to be considered on the basis of written submissions.

However, again there is a distinction. In *Pennsylvania Coal* the Court held that notice and the opportunity to present written objections before proposed insurance rates were deemed into effect by virtue of the Insurance Commissioner's inaction were adequate due process protections when coupled with the opportunity to challenge the rates later in a full hearing before the Insurance Commissioner pursuant to section 814. In other words, the Court did not view the deeming of rates into effect as a final, affirmative approval of those rates by the Insurance Department, not subject to later challenge. By contrast, in the present case, final affirmative approval is precisely what West Penn sought, and received, from the PUC. If the commission's order is affirmed by the courts, then the propriety of the contract's capacity cost credit rate will not be subject to later challenge in a complaint proceeding before the commission under section 701; that issue will have been fully adjudicated already in these proceedings. Therefore, the present circumstances are not analogous to those in *Pennsylvania Coal*.

Ultimately, then, the present circumstances are closest to those in *Conestoga*. Unless notice and an opportunity to be heard on the issue of the propriety of the contract rates are provided *before* final PUC approval of the terms of a contract between a utility and a QF, they will not be provided at all.

We disagree with West Penn's contention in its appeal that the due process rights of its customers would be protected adequately by a procedure involving publication of the commission's decision in the *Pennsylvania Bulletin* followed by a thirty-day period in which interested persons might submit written comments on the decision. First, such a procedure would needlessly postpone the

customers' opportunity to challenge the proposed action until after the commission had formulated a decision on the matter and had a stake in preserving that decision. Unlike the circumstances involving current utility fuel expenses present in *Allegheny Ludlum*, the utility here is not now incurring expenses that it must recover immediately in order to preserve its financial health. Here no obligations arise until the PUC approves the contract. Second, such a procedure would allow only written submissions, without any later opportunity for a full hearing, as in *Pennsylvania Coal*.

In our view, due process requires that, before the PUC may issue a declaration approving the legality of the terms and conditions of a contract for a utility's purchase of power from a QF that includes payments for capacity, the utility's customers must be provided with notice of the proceedings and an opportunity to be heard to challenge the proposed action.

The only question remaining, regarding the opportunity to be heard, is whether the procedure adopted must take the form of a full, trial-type hearing.

In *American Paper Institute* the United States Supreme Court quoted from the Congressional Conference Report on PURPA in support of the Court's determination that Congress did not intend to impose traditional ratemaking concepts on sales by qualifying facilities to utilities:

> 'The conferees recognize that cogenerators and small power producers are different from electric utilities, not being guaranteed a rate of return on their activities generally
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> . . . .
>
> '[C]ogeneration is to be encouraged under this section and therefore the examination of the level of rates which should apply to the purchase by the utility of the cogenerator's or small power producer's power should not be burdened by the same examina-

> tion as are utility rate applications, but rather in a less burdensome manner. The establishment of utility type regulation over them would act as a significant disincentive to firms interested in cogeneration and small power production.'

American Paper Institute, 461 U.S. at 414, 103 S.Ct. at 1928-29 (quoting H.R.Conf.Rep. No. 95-1750, 95th Cong., 2d Sess. at 97-98 (1978)). *Conestoga* itself approved the use of proceedings of less formality than a full trial-type adversary hearing.

Given the federal and state policy of encouraging the development of cogeneration and small power production, in part by minimizing the burdens involved in the examination of rates of purchases of power by utilities from QFs, the commission must devise a procedure that provides the essential elements of a hearing, but allows for consideration of petitions of the type involved here in as expeditious and minimally burdensome a manner as possible. The commission should make its own calculations of the maximum allowable capacity cost credit part of the record of the proceeding, and it should provide access to its calculations to interested parties before the hearing.[13]

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[13] The commission initiated a generic investigation and reexamination of its regulations implementing section 210 of PURPA by order entered April 10, 1987, at Docket No. I-860025, *Investigation Upon the Commission's Own Motion Into the Regulations at 52 Pa.Code § 57.31 et seq.*, in order that the commission might, possibly, revise its regulations in light of the experience it has gained since their adoption. The commission takes the position that any amendments to its regulations resulting from that investigation would apply prospectively, only, and would not affect existing agreements between utilities and QFs. Although we agree with that proposition, we note that no contract exists yet between West Penn and MEI because the condition precedent of a commission order approving the terms of the contract, final beyond appeal, has not been satisfied. Should the commission's investigation result in the adoption of procedures consistent with this opinion before the commission reconsiders this case on remand, application of those procedures to the reconsideration of this contract would be proper.

Finally, we must consider the issue of the manner of notice that is necessary to assure that the hearing the commission provides adequately protects the due process rights of West Penn's customers. The commission's regulations grant the commission broad discretion in prescribing the form of notice appropriate for the type of rate increase involved here:

> For other proposed changes in rates [those that do not constitute a "general rate increase" within the meaning of 66 Pa.C.S. § 1308(d) (relating to voluntary changes in rates)], rules and regulations, including but not limited to, nongeneral rate increases, proposed changes in regulations—without rate changes—and proposed rate changes under 66 Pa.C.S. § 1307(f) (relating to sliding scale of rates; adjustments), public notice of the proposed changes shall be given in a manner directed by the Commission.

52 Pa.Code § 53.45(c). The commission's regulations relating to notice procedures for general rate increases, contained in 52 Pa.Code § 53.45(a), require a utility to post notice of proposed increases in company offices, § 53.45(a)(1), to issue news releases on the date the increase is filed, § 53.45(a)(3), and to mail or to hand deliver a written or printed notice to each ratepayer, § 53.45(a)(2). In lieu of the mailing or hand delivery method, "a public utility on a 1-month billing cycle filing a proposed general rate increase in excess of $1 million may notify its customers by means of a bill insert." § 53.45(a)(4).

West Penn's suggested manner of providing notice—publication of a commission order in the *Pennsylvania Bulletin*—is not adequate under the circumstances of this case. As Armco/Allegheny argues, this nongeneral rate increase in excess of $10 million should be subject to notice procedures at least as thorough as those required for a general rate increase of $1 million.

In order to guarantee fulfillment of the requirements of due process in this case, the commission should require West Penn to provide notice to its customers in a manner consistent with that prescribed in 52 Pa.Code § 53.45(a), allowing for bill inserts in lieu of mailed or hand delivered individual notices.

B. *Excess Capacity*

The sole contention of the Office of Consumer Advocate in its petition at No. 2418 C.D. 1987 is that, on both due process and statutory grounds, the PUC cannot issue an order declaring that the 43 megawatts of new electric generating capacity from the Milesburg project must be totally ignored in all rate cases over the next thirty years for the purpose of determining whether West Penn has excess capacity. The fourth ordering paragraph of the commission's order is as follows:

> 4. [T]he Commission hereby declares that the additional generating capacity as a result of the contract between West Penn Power Company and Milesburg Energy, Inc., referenced in Ordering Paragraph No. 1, above, shall not be considered by the Commission in determining the reserve margins or economic benefits resulting from any base load or other generating unit during the terms [sic] of the contract.

Arguing on the basis of the *Conestoga* line of cases, discussed above, OCA contends that this ordering paragraph violates the due process rights of West Penn's ratepayers in that, by precluding the commission from considering this capacity as to the excess capacity analysis in any West Penn rate case until the year 2020, the order deprives parties to such future rate cases of notice and an opportunity to be heard on the issue of the effect of this capacity on West Penn's overall capacity.

The commission essentially has conceded OCA's due process argument to the extent that it relates to *future*

excess capacity determinations involving facilities that West Penn has not yet built. The commission now disavows any intent to preclude consideration of the Milesburg unit capacity during the entire term of the contract, noting that West Penn's petition requested only an order stating that the addition of the MEI capacity does not result in excess capacity as to the MEI capacity itself or as to any *existing* West Penn capacity.

Further, the commission notes that the body of the order stated that the relief requested by West Penn was consistent with the commission's current thinking as expressed in the proposed "Policy Statement on the Treatment of Qualifying Facilities in Excess Capacity Determinations" (Policy Statement).[14] The proposed Policy Statement declares that in most cases excluding QF capacity from excess capacity calculations pursuant to section 1323 of the Public Utility Code, 66 Pa.C.S. § 1323, is appropriate and consistent with legislative intent, but that this principle does not apply where a utility purchases firm, long-term QF capacity and then later fails to defer or to cancel planned construction of its own generating capacity that the QF purchase should have enabled the utility to avoid.

OCA, in its reply brief, characterizes the commission's restrictive interpretation as a significant improvement over the original order. Nevertheless, OCA repeats its due process objection to the commission's exclusion of the MEI capacity from excess capacity determinations involving only West Penn's *existing* capacity.

Under the *Conestoga* line of cases, OCA's position is correct. First, the commission's decision to disregard the

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[14] The policy statement, proposed to be added to the PUC's regulations implementing PURPA at 52 Pa.Code § 57.40, was published in the *Pennsylvania Bulletin* for public comment, along with an order explaining the reasons for the policy, on July 18, 1987. 17 Pa.B. 3035. At this writing, the commission has not adopted the proposed regulation.

Milesburg project capacity involved substantial property interests. Second, under the circumstances of this case, the commission's action was adjudicatory in nature. The definition of "adjudication" is provided in 2 Pa.C.S. § 101:

> Any final order, decree, decision, determination or ruling by an agency affecting personal or property rights, privileges, immunities, duties, liabilities or obligations of any or all of the parties to the proceeding in which the adjudication is made.

The commission's order here was a final order affecting property interests and rights of ratepayers. The commission cannot rely on the proposed, but unadopted, Policy Statement as a reflection of the commission's "current thinking" in order to justify depriving ratepayers of notice and an opportunity to be heard on the issue of the relation of this QF capacity to West Penn's overall capacity.

The situation might be different if the commission had adopted the Policy Statement as a regulation, thereby giving the Policy Statement the force and effect of law. In that case the commission's *legislative* action (with its own attendant procedures) in implementing a policy decision by adopting the Policy Statement would have *altered* ratepayers' rights on this issue. Therefore, the commissioner's order on a petition such as West Penn's, although final, would not be the administrative action that affected ratepayers' rights.

However, because the commission has not adopted the Policy Statement, the commission's order *in this case* is the administrative action that affects the ratepayers' rights regarding the excess capacity treatment of the Milesburg project capacity, and hence is adjudicatory in nature. This conclusion does not mean that the commission does not have the power to decide to disregard the Milesburg project capacity in excess capacity determinations involving West Penn's existing capacity, but rather that the commission may not make such a decision without first pro-

viding the ratepayers with notice and a hearing. Accordingly, in the commission's proceeding on remand, the commission should afford ratepayers the opportunity to be heard on that issue also.

Because the commission decided to disregard the Milesburg project capacity without providing ratepayers due process of law, we are remanding for the commission to reconsider its decision after providing due process for constitutional reasons. For that reason, OCA's statutory basis for attacking the commission's decision—the claim that section 1323 of the Public Utility Code, 66 Pa.C.S. § 1323, precludes the commission from disregarding capacity except in narrowly defined circumstances not applicable here—is not yet ripe for adjudication.

C. *Levelized Capacity Payments*

Armco/Allegheny also contends that the provision for levelized capacity payments in the contract between West Penn and MEI violates federal and state law. First Armco/Allegheny asserts that the prohibition in section 210(b) of PURPA against a rate greater than the incremental cost to the utility of alternative electric energy, taken together with FERC's rule stating that nothing in its regulations requires a utility to pay more than avoided cost for purchases, 18 C.F.R. § 292.304(a)(2), means that a utility may not make front-end loaded levelized capacity payments to a QF, because such payments would exceed the actual FAC in the early years of a contract.

This argument fails to account for 18 C.F.R. § 292.304 (b)(5), which provides:

> In the case in which rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery.

In the preamble to its February 25, 1980, rulemaking, FERC explained the rationale behind this rule in part as follows:

> A facility which enters into a long term contract to provide energy or capacity to a utility may wish to receive a greater percentage of the total purchase price during the beginning of the obligation. For example, a level payment schedule from the utility to the qualifying facility may be used to match more closely the schedule of debt service of the facility. So long as the total payment over the duration of the contract does not exceed the estimated avoided costs, nothing in these rules would prohibit a State regulatory authority or non-regulated electric utility from approving such an arrangement.

45 Fed.Reg. 12224. Contrary to Armco/Allegheny's assertion in its reply brief, this regulation, as explained by the preamble, is not ambiguous. Federal law encourages, rather than prohibits, levelized capacity payments.

Next Armco/Allegheny asserts that the levelized capacity payments to MEI violate section 1323 of the Public Utility Code [15] because, until such time as the capacity

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[15] Section 1323, added to the Public Utility Code by section 9 of Act 114, Act of July 10, 1986, P.L. 1238, provides in part as follows:

> (a) Excess capacity costs.—Whenever a public utility claims the costs of an electric generating unit in its rates for the first time and the commission finds that the unit results in the utility having excess capacity, the commission shall disallow from the utility's rates, in the same proportion as found to be excess capacity:
>
> (1) the return on specific unit or units of any excess generating reserve;
>
> (2) the return on the average net original cost per megawatt of the utility's generating capacity; or
>
> (3) the equity investment in the new unit. In addition to the disallowances set forth in this subsection, the commission may disallow any other costs of the unit or units which the

is actually needed, which is projected to be in the fourth quarter of 1995, the levelized payments will be for capacity that is excess. A determination of this issue necessarily is bound up with the decision of the commission on remand regarding whether the commission should exclude the Milesburg project capacity from excess capacity determinations involving only West Penn's existing capacity. If, after providing notice and a hearing on remand on the excess capacity issue, the commission lawfully decides to disregard the Milesburg project capacity, then this argument will be answered as well. Capacity that is lawfully disregarded is not excess.

This conclusion is entirely consistent with the overall thrust of section 210 of PURPA, which was to encourage the development of alternative power sources immediately, in order to wean the nation from foreign oil and natural

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commission deems appropriate. For the purposes of this section, a rebuttable presumption is created that a unit or units or portion thereof shall be determined to be excess unless found to be needed to meet the utility's customer demand plus a reasonable reserve margin in the test year or the year following the test year, or, if it is a base load unit, it is also found to produce annual economic benefits which will exceed the total annual cost of the plant during the test year or within a reasonable period following the test year.

. . . .

(c) Other powers and duties preserved.—This section shall not be construed to diminish the powers and duties of the commission under any other provision of law to reduce rates because of excess capacity or any other reason, provided that, in determining whether a base load unit, which was in commercial operation for a least one year prior to the effective date of this section [before July 10, 1985], results in a public utility having excess capacity, cogeneration, for which an agreement has been entered into by the public utility within three years after the in-service date of the base load unit, shall not be considered by the commission in determining reserve margins or economic benefits resulting from the base load unit for the first five years after the date of the cogeneration agreement.

gas as quickly as possible. FERC's explanation of its regulation requiring capacity payments as well as energy payments to QFs, where appropriate, *see* n. 4, *supra*, indicates that if a utility had excess capacity, and would continue to have excess capacity from its own already-existing resources through the term of a contract with a QF, then no capacity payment would be appropriate, because the utility would not be avoiding any capacity costs by virtue of the purchase. Nevertheless, PURPA would still compel the utility to purchase power from the QF, paying only energy costs.[16] However, where, as here, the capacity offered by the QF definitely will be needed by the utility during the term of the contract, the purchase does permit the utility to avoid some future capacity costs. The levelization of these avoided capacity payments to a QF over a period beginning before the date when the capacity is actually needed does not violate section 1323.

Armco/Allegheny also argues that levelized capacity payments violate the "spirit" of section 1315 of the Public Utility Code, 66 Pa. C.S. § 1315, which prohibits rate recovery by a utility for expenses it incurs for construction work in progress that the utility has undertaken on a base load unit until such time as the unit is "used and useful" to the utility's customers, which is deemed to be when the unit is presently providing actual utility service to them. By arguing that the Milesburg project energy will not be used and useful to West Penn's customers until 1995, when the capacity is first needed, Armco/Allegheny confuses the section 1315 concept of actual delivery of power with the section 1323 concept of excess capacity. The contract between West Penn and MEI in

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[16] The apparent inefficiency of such compelled purchases should be greatly alleviated by PURPA's encouragement of the practice of "wheeling" electricity, that is, of transmitting the power through the lines of an interconnecting utility that does not need the power to another utility that does. *See* 18 C.F.R. § 292.303(d) *and* 45 Fed.Reg. 12219.

fact incorporates the used and useful concept of section 1315 by providing that West Penn will not make payments to MEI until the Milesburg project actually delivers power to West Penn.[17]

CONCLUSION

Accordingly, an appropriate remanding order follows.

ORDER

NOW, August 22, 1988, the order of the Pennsylvania Public Utility Commission at Docket No. P-870216, entered September 22, 1987, is hereby vacated. We remand this matter for the commission to reconsider (1) its declaration that the terms of the proposed contract between West Penn Power Company and Milesburg Energy, Inc., including the capacity cost credit rate specified in the contract, are in the public interest and (2) its declaration that the commission will not consider the capacity from the Milesburg project in excess capacity determinations, after providing West Penn's ratepayers with notice and an opportunity to be heard on these issues in a manner consistent with the foregoing opinion.

Jurisdiction relinquished.

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[17] Armco/Allegheny raises two other issues that are irrelevant to these proceedings. The claim that the proceeds of the sale of the Milesburg Power Station to MEI should be distributed to West Penn's ratepayers, rather than to its shareholders, may be an appropriate issue in West Penn's next general rate case; however, that issue has no bearing on whether this agreement and its purchase rates are proper. Similarly, Armco/Allegheny's claim that the agreed purchase rate is not "just and reasonable" because the Allegheny Power System, of which West Penn is a member, has recently agreed to sell power to an electric power cooperative in Virginia for seven years at a rate substantially below that involved in this contract simply does not relate to the question of whether the rate negotiated with MEI is equal to or below FAC.

APPENDIX F

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice Chairman
Linda C. Taliaferro
Joseph Rhodes, Jr.
Frank Fischl

Docket No. P-870216

PETITION OF MILESBURG ENERGY, INC. FOR MODIFICATION OF AN ELECTRIC ENERGY PURCHASE AGREEMENT AN ORDER PROHIBITING CONSTRUCTION OF ELECTRIC GENERATING UNITS, FOR THE INITIATING OF AN INVESTIGATION AND A STATEMENT OF POLICY

CONSENT ORDER

BY THE COMMISSION:

1. On or about February 25, 1987, Milesburg Energy, Inc. ("MEI") and West Penn Power Company ("West Penn") executed an Electric Energy Purchase Agreement ("Agreement") subject to certain conditions precedent.

2. One of the conditions precedent to the Agreement at Section 5.3(i) was that West Penn would have no obligations under the Agreement until an order of the Pennsylvania Public Utility Commission ("Commission")

approving the terms of the Agreement and a full and immediate pass-through of the costs incurred by West Penn under the Agreement was final beyond appeal.

3. The terms of the Agreement also contain certain milestone dates by which certain matters must be accomplished. One of these terms, set forth in Section 10.2 of the Agreement, provides for its automatic termination and stated, in pertinent part:

> "If the Financing Closing Date shall not occur prior to September 1, 1988 for any reason whatsoever, including Force Majeure, this Agreement shall automatically terminate, in which case neither party shall have any further liability to the other hereunder."

4. On or about April 2, 1987, West Penn filed a Petition with the Commission requesting that the Commission publish a declaratory order in the *Pennsylvania Bulletin* for public review and comment stating that (1) exceptions to the Commission's tentative approval of the Agreement with MEI as complying with section 210 of PURPA and with the Public Utility Code must be filed within thirty days of publication; (2) upon the occurrence of the conditions precedent the Commission would authorize West Penn to pass the charges resulting from the agreement through to its customers by the mechanism of the Energy Cost Rate or such other method as might replace the ECR; and (3) the addition of the Milesburg project capacity would not result in an excess capacity determination under the Public Utility Code as to the MEI capacity itself or as to any existing West Penn capacity.

5. By Order dated September 17, 1987, entered September 22, 1987, the Commission granted West Penn's Petition except that the Commission did not provide for the order being published in the *Pennsylvania Bulletin* but rather entered a final Opinion and Order. This Opinion and Order was subsequently appealed to the Pennsylvania Commonwealth Court.

6. On or about August 3, 1988, MEI filed a Petition ("Petition") with the Commission requesting a modification in the Agreement that would have the practical effect of indefinitely extending certain milestone dates, including the Financing Closing Date, due to delays caused by the appeal of the Commission Opinion and Order in this case.

7. West Penn, the Office of the Consumer Advocate and the Office of Trial Staff of the Commission filed responses to the Petition. Armco, Inc. and Allegheny Ludlum Corporation filed a Motion to Dismiss the Petition.

8. By Opinion and Order dated August 22, 1988, the Pennsylvania Commonwealth Court at Nos. 2418, 2499 and 2522 C.D. 1987 vacated the Commission Opinion and Order entered September 22, 1987, and remanded the same to the Commission for further action ("Commonwealth Court Order").

9. The time necessary for the Commission to fulfill the requirements of the Commonwealth Court Order will extend well beyond the milestone date for the Financing Closing Date (prior to September 1, 1988), as set forth in Section 10.2 of the Agreement, for automatic termination of the Agreement.

10. West Penn believes that it cannot prudently agree to an indefinite extension of any of the performance dates in the Agreement because such extensions could interfere with the orderly generation planning process to the detriment of West Penn and its customers.

11. The parties to this Consent Order have agreed to delay the automatic termination of the Agreement for a specific, limited time period to provide an opportunity for the Commission to fulfill the requirements of the Commonwealth Court Order, provided that all parties listed in the attached Consent execute the attached Consent, and provided further that the Commission approves this Order. It is understood that the Consent may be executed in counterparts by the various parties.

The parties hereto have also agreed to the following terms:

1. The Financing Closing Date set forth in Section 10.2 of the Agreement is hereby extended to and including February 28, 1989, and any other dates, including the earliest possible Commencement Date, in the said Agreement that is dependent on the said Financing Closing Date is extended for a like period. Should the Financing Closing Date not occur on or before February 28, 1989, the Agreement will automatically terminate pursuant to Section 10.2, unless otherwise extended by further order of this Commission.

2. Any hearing held pursuant to the Order of the Commonwealth Court dated August 22, 1988 shall include the receipt of evidence related to, and an express determination of, whether and to what extent the Commission should consider a further extension of the Financing Closing Date of the Agreemennt beyond February 28, 1989, and any other date that is dependent on the said Financing Closing Date, as may be necessary to obtain a final Order of the Commission including any appeals.

3. MEI shall not seek nor be entitled to any capacity credit higher than that specified in the Agreement executed on or about February 25, 1987.

4. Any additional relief requested by MEI in its Petition is denied.

5. The West Penn Industrial Intervenors shall be permitted to intervene in any Commission proceeding held in accordance with the Order of the Commonwealth Court dated August 22, 1988.

NOW, THEREFORE, IT IS ORDERED THAT:

1. The Financing Closing Date set forth in Section 10.2 of the Agreement is hereby extended to and including February 28, 1989, and any other dates, including the earliest possible Commencement Date, in the said Agree-

ment that is dependent on the said Financing Closing Date is extended for a like period. Should the Financing Closing Date not occur on or before February 28, 1989, the Agreement will automatically terminate pursuant to Section 10.2, unless otherwise extended by further order of this Commission.

2. Any hearing held pursuant to the Order of the Commonwealth Court dated August 22, 1988 shall include the receipt of evidence related to, and an express determination of, whether and to what extent the Commission should consider a further extension of the Financing Closing Date of the Agreement beyond February 28, 1989, and any other date that is dependent on the said Financing Closing Date, as may be necesasry to obtain a final, nonappealable Order of the Commission including any appeals.

3. MEI shall not seek nor be entitled to any capacity credit higher than that specified in the Agreement executed on or about February 25, 1987.

4. Any additional relief requested by MEI in its Petition is denied.

5. West Penn Industrial Intervenors shall be permitted to intervene in any Commission proceeding held in accordance with the Order of the Commonwealth Court dated August 22, 1988.

By the Commission

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

Order Adopted: September 1, 1988

Order Entered: September 1, 1988

CONSENT

Intending to be legally bound, the following parties hereby consent to the foregoing Consent Order provided that this Consent will become void and of no effect should any of the following occur: 1) the Commission fails to adopt and enter the foregoing Consent Order; 2) any of the parties identified in the Consent refuse to agree and execute this Consent through their authorized agent(s).

/s/

Attorney for Armco, Inc. and
Allegheny Ludlum Steel
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/s/

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/s/

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/s/

Attorney for Milesburg
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Philadelphia, PA 19102

Dated as of August 31, 1988

APPENDIX G

COMMONWEALTH COURT OF PENNSYLVANIA

DAVID M. BARASCH, CONSUMER ADVOCATE,
Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent.

ARMCO, INC. and ALLEGHENY LUDLUM CORPORATION,
Petitioners,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent.

WEST PENN POWER COMPANY,
Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
Respondent.

Nov. 3, 1988

Before CRUMLISH, Jr., President Judge, and CRAIG, DOYLE, BARRY, PALLADINO, McGINLEY and SMITH, JJ.

CRAIG, Judge.

Upon consideration of Petition for Reargument filed on behalf of the Pennsylvania Public Utility Commission (PUC) and the answers to that petition, the court concludes that the only new matter raised is the request for a declaration that the opinion and order of this court, dated August 22, 1988, —— Pa.Cmwlth. ——, 546 A.2d 1296, shall have prospective effect, rather than retroactive effect. In the course of the principle briefing and argument of the case, there was no request from any party for such a declaration, either by way of alternative relief or by way of modification of relief which might be granted.

In view of the questions of first impression involved in this case, the resolution of which could not have been clearly foreshadowed, this court's intention is that the decision shall have only prospective effect. *Chevron Oil Company v. Huson*, 404 U.S. 97, 92 S.Ct. 349, 30 L.Ed.2d 296 (1971).

Therefore, the court declares that the decision in this case, dated August 22, 1988, shall not have retroactive effect, but shall be applicable only to the petition for approval of the proposed contract in this case, between West Penn Power Company and Milesburg Energy, Inc., and to any petitions filed with the PUC after August 22, 1988 for approval of contracts covered by the Federal Public Utility Regulatory Policies Act of 1978.

The petition for reargument shall in other respects be denied.

ORDER

NOW, November 3, 1988, upon consideration of petition for reargument on behalf of the Pennsylvania Public Utility Commission and answers thereto, a declaration of prospective effect of this court's decision is hereby adopted as stated in the foregoing opinion, and the petition for reargument in other respects is denied.

APPENDIX H

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held January 19, 1989

Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice Chairman
Joseph Rhodes, Jr.
Frank Fischl

Docket Nos. P-870216 P-880283 P-880284 P-880286

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS

Re: MILESBURG ENERGY, INC.
MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

OPINION AND ORDER ON RECONSIDERATION

BY THE COMMISSION:

INTRODUCTION

On September 30, 1988, we entered an Order at Docket Nos. P-880283, P-880284, and P-880286 that, *inter alia*, consolidated those proceedings for the purpose of

hearing and assigned them to the Office of Administrative Law Judge ("OALJ"). On October 27, 1988, we entered an Order at these docket numbers that granted, pending further consideration of the merits, the variously-styled Petitions for Reconsideration that were filed by the West Penn Power Industrial Intervenors ("WPPII"), Armco, Inc. and Allegheny Ludlum Corporation ("Armco/Allegheny"), North Branch Energy Partners ("North Branch"), and West Penn Power Company ("West Penn").

Our order of today's date addresses the various Petitions for Reconsideration on the merits. In addition, it formally consolidates the proceeding at Docket P-870216, which pertains to Milesburg Energy, Inc., with the other three proceedings that we previously consolidated for the purpose of hearing.

BACKGROUND

Our September 30, 1988 Order was issued in response to *Barasch v. Pennsylvania Public Utility Commission*, —— Pa. Commonwealth Ct. ——, 546 A.2d 1296 (1988) ("*Milesburg*"). As we noted, the Commonwealth Court in that appeal vacated our order at Docket No. P-870216 of September 22, 1987 granting West Penn's Petition for rate recovery approval of amounts proposed to be paid to Milesburg Energy, Inc. ("MEI") and remanded the proceeding to the Commission. The Commonwealth Court concluded that the capacity credit proposed to be paid to MEI involved substantial property interests of West Penn's ratepayers, and that these interests, in combination with the adjudicatory nature of the Commission's September 22, 1987 Order, required that ratepayers be given notice of the filing of the petition and that "the [C]ommission must devise a procedure that provides the essential elements of a hearing, but allows for consideration of petitions of the type involved here in as

expeditious and minimally burdensome a manner as possible." 546 A.2d at 1307.

Pursuant to our September 30, 1988 Order, West Penn has provided notice of the filing of all four above-captioned petitions, including the petition governing its proposed power purchase agreement with MEI, by bill insert. Although we may not have had jurisdiction over the Milesburg proceeding on September 30, 1988 due to our Petition for Reargument of September 6, 1988 that was then pending before the Commonwealth Court, West Penn included notice of the MEI petition in its bill inserts pursuant to our request and in order to facilitate future consolidation of the MEI petition with the other three proceedings. Consequently, notice of the filing of all four petitions has been perfected.

On November 3, 1988, the Commonwealth Court filed an opinion and order in *Milesburg* granting in part and denying in part the Commission's Petition for Reargument. Relevant to the instant proceedings, the Commonwealth Court held that its August 22, 1988 decision "shall not have retroactive effect, but shall be applicable only to the petition for approval of the proposed contract in this case, between West Penn Power Company and Milesburg Energy, Inc., and to petitions filed with the PUC after August 22, 1988." Although West Penn's petitions governing Monongahela Lock and Dam No. 8 and the Burgettstown and Shannopin Mine Projects were filed *before* August 22, 1988, we will voluntarily apply the *Milesburg* requirements to these proceedings as contemplated by our September 30, 1988 Order. Our Petition for Reargument had requested only that prior Commission decisions approving rate recovery under PURPA 210 be, in essence, grandfathered under *Milesburg*.

On December 5, 1988, we filed a Petition for Allowance of Appeal of *Milesburg* with the Pennsylvania Supreme Court. The only aspect of *Milesburg* for which

we have sought review is the Commonwealth Court's prescription of the form of notice that the Commission must provide of rate recovery petitions similar to the one governing the proposed power purchase agreement between West Penn and MEI. Under the Pennsylvania Rules of Appellate Procedure, our Petition for Allowance of Appeal of this limited aspect of the Commonwealth Court's Opinion and Order does not prevent us from proceeding with the West Penn petition governing the proposed power purchase agreement with MEI. Pa. R.A.P. 1701(c). No other Petition for Allowance of Appeal of *Milesburg* having been filed,[1] our Order of today's date will formally consolidate all four docket numbers for the purpose of hearing.

DISCUSSION

The four variously-styled Petitions for Reconsideration will be discussed separately as set forth below.

West Penn filed a Petition for Reconsideration of our September 30, 1988 Order and a Request for Extraordinary Relief on October 17, 1988.[2] West Penn avers that it must have the proceeding concluded as quickly as possible in order to properly and orderly plan its generating capacity to serve the future needs of its ratepayers, and notes that the "litigation in these matters and in

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[1] MEI filed a Cross-Petition for Allowance of Appeal on December, 19, 1988 which subsequently has been withdrawn.

[2] MEI filed an Answer supporting West Penn's Petition and Request on October 27, 1988. MEI avers that prompt resolution of the proceedings is critical to it due to the Financial Closing Date of February 28, 1989 for its project. OCA, WPPII and Armco/Allegheny jointly filed an Answer opposing West Penn's Request for Extraordinary Relief on October 26, 1988, generally opposing the procedural schedule proposed by West Penn. OCA also on October 26, 1988 filed a Response supporting West Penn's and related Petitions for Reconsideration to the extent the Petitions seek clarification that the September 30 Order does not contain any final determinations of contested issues.

the Milesburg case collectively involve more than 200 MW of generating capacity . . . and creates uncertainty as to whether West Penn will be able to rely on these projects to meet its future generation needs." Petition, p. 4. In order to expedite the hearing process, West Penn requests that the Commission itself, rather than the OALJ, preside over the hearings. This procedure would, according to West Penn, avoid the procedural delay occasioned by the time allowed for the filing of exceptions to the ALJ's recommended decision and the time necessary for the Commission to study the record in order to rule on the exceptions.

Although we are cognizant of the need to conclude these proceedings as quickly as possible, we will deny this request. It would not be practical to attempt to schedule evidentiary hearings before four Commissioners, all of whom have competing demands for their time and attention. Nevertheless, we will direct the OALJ to expedite the proceeding in any manner that is possible. Our September 30, 1988 Order implicitly conveyed as much by citing to the Commonwealth Court's directive to provide the "essential elements of a hearing" in a proceeding allowing for "consideration of the type involved here *in as expeditious and minimally burdensome a manner as possible.*" 546 A.2d at 1307 (emphasis supplied). Although we will not establish a firm deadline for the issuance of a recommended decision by the OALJ due to our inability to foresee all contingencies, we would request that a recommended decision be issued within two to three weeks after main briefs are filed, and suggest that the filing of reply briefs be eliminated. If hearings can be concluded by the end of February, this would permit the issuance of the recommended decision by the end of March.

West Penn also requests that the Commission provide for a trial type proceeding rather than a rate case type proceeding. By a trial type proceeding, West Penn means

a procedure whereby a mutual discovery period is followed by a continuous hearing at which all witnesses and all cross-examination are presented on a continuous basis. West Penn states that, in order to facilitate such a proceeding, liberal discovery should be allowed but a cutoff should be required before the hearings.

As we have decided that these proceedings should remain assigned to the OALJ, we shall refer consideration of this request to the ALJ assigned to the proceeding.

Finally, West Penn requests that the Commission indicate that the September 30, 1988 Order is not a final and appealable order, and that the final and appealable Order will not be rendered until the proceedings are concluded at the Commission. West Penn notes that granting this request would avoid the delay that could occur if the September 30 Order were appealed to the Commonwealth Court. West Penn suggests that the Commission order that all parties shall retain their rights to appeal any aspect of the September 30 Order until the conclusion of the appeal period following the entry, after hearing, of a final order on the merits. North Branch, the developer of the Burgettstown Project, similarly requests in its Motion for Reconsideration of October 17, 1988 that the Commission add an ordering paragraph to its September 30 Order stating that the Order is interlocutory in order to eliminate any appeals until the entry of a final order.

We will grant the requests of West Penn and North Branch and explicitly state what already is implicit, e.g., that the September 30 Order, as well as today's Order, are interlocutory only, and that all parties will have the opportunity to appeal any issue decided by the interlocutory orders at the conclusion of these proceedings.

WPPII filed a Petition for Reconsideration of the September 30 Order on October 14, 1988. WPPII objects to our directive to the OALJ to exclude the issue of the

appropriateness of levelization of rates paid to qualifying facilities from the scope of the proceeding. WPPII avers that, although the Commonwealth Court determined that levelized payments are consistent with Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3 ("PURPA"), the Court did not rule on the issue of whether the portion of the levelized payment which exceeds current avoided costs is recoverable from ratepayers on a current basis. WPPII requests that it be permitted to introduce testimony regarding a deferral mechanism that would delay recovery by West Penn of amounts paid to the qualifying facilities that exceed West Penn's current avoided costs.

WPPII's position on this issue has been considered and rejected by this Commission on *numerous* occasions, beginning with *AES Beaver Valley v. West Penn Power Co.*, Docket No. C-844022 (March 13, 1985). In fact, the Lehigh Valley Power Committee ("LVPC"), which is represented by the same law firm as WPPII, in the last several months has appealed two Commission Orders to the Commonwealth Court on this identical issue. The first appeal, at No. 1002 C.D. 1988, was argued before the Commonwealth Court on November 2, 1988. The second appeal, at No. 1620 C.D. 1988 was subject of a Commission brief filed with the Commonwealth Court on November 21, 1988. As we have noted over and over again, federal law expressly sanctions levelization of rates paid to qualifying facilities, our regulations require the payment of levelized rates, and there is nothing under federal law which defines or permits a concept of "ratepayers' avoided costs" separate from a utility's avoided costs. To the contrary, Congress and the Federal Energy Regulatory Commission ("FERC") have defined "full avoided costs", including levelized costs, as those which *are* just and reasonable to electric consumers. 16 U.S.C. § 824a-3(b) and (d); *American Paper Institute v. American Electric Power Service Corporation*, 461 U.S. 402

(1983). WPII's request essentially is a collateral attack upon the framework of FERC's regulations implementing PURPA, our own regulations implementing PURPA 210, and the numerous Commission Orders that have considered and rejected this issue in the past. An appropriate proceeding available to WPPII to raise this issue on a generic basis is the *Investigation upon the Commission's Own Motion Into the Regulations at 52 Pa. Code § 57.31 et seq.*, Docket No. I-860025, which was designed to review our PURPA 210 regulations and make any necessary or appropriate changes to them on a prospective basis. Absent any change to our regulations, rate levelization and rate recovery of levelized payments are required in Pennsylvania. Granting WPPII's petition for reconsideration on this issue therefore would serve no useful purpose, and simply would waste the parties' and our own time and resources, and needlessly delay the proceedings that of necessity must be concluded in as expeditious a manner as possible. Of course, our explicit recognition of the interlocutory nature of this and our September 30 Order preserves WPPII's right to appeal this issue at the conclusion of the proceeding. The issue of the levelization of payments to qualifying facilities and the rate recovery thereof being so fundamentally a cornerstone of our implementation of PURPA, we perceive no danger in excluding this issue from the scope of the proceeding prior to hearing.

The final pleading to be addressed is Armco/Allegheny's Petition for Reconsideration of October 17, 1988.[3]

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[3] West Penn filed a Reply to Armco/Allegheny's Petition on October 31, 1988. West Penn requests that the Petition be denied except to the extent it requests that the September 30 Order be deemed interlocutory and to the extent that in West Penn's view the fundamental issue to be resolved is whether the proposed rates are at or below West Penn's avoided costs as calculated by West Penn's methodology, as opposed to the methodology set forth in the Commission's regulations.

Armco/Allegheny request that we reconsider certain aspects of our September 30 Order or, in the alternative, modify the Order to state that no final determination has been made regarding these aspects of our Order. Armco/Allegheny's alternative request, which is granted as set forth above, was made to prevent the necessity of filing an interlocutory appeal prior to the conclusion of the proceeding. Armco/Allegheny's other arguments focus on the statement in our September 30 Order at page 3 that "the fundamental factual issue to be resolved is whether the proposed rates are at or below West Penn's full avoided costs as defined by our regulations at 52 Pa. Code § 57.31 *et seq.* If the rates are at or below the rates to which the developers would be entitled as a matter of law, the rates are *per se* reasonable and automatically are recoverable from ratepayers." Armco/Allegheny's objection to this language is based on Section 527 of the Public Utility Code, 66 Pa. C.S. § 527, which states, *inter alia*, that "[T]he Commission shall require that utility rates to the public reflect savings to the utility from cogeneration." Armco/Allegheny have cited this statutory language as support for the somewhat novel proposition that our regulations implementing PURPA 210 cannot be used as the benchmark for determining the reasonableness of rates paid to qualifying facilities. This argument requires little attention. Suffice it to say that, absent a voluntary agreement otherwise, rates paid to a qualifying facility must be based under federal law on a utility's *full* avoided costs, and any state requirement that a qualifying facility involuntarily accept a lower rate would be preempted. As we are unaware of any support for Armco/Allegheny's assertion that the General Assembly intended to exempt Pennsylvania from the full avoided cost rule, we reject this argument. Statutes may be interpreted by presuming that the General Assembly did not intend to violate the Constitution of the United States. 1 Pa. C.S. § 1922(3).

Armco/Allegheny's second point on which it seeks reconsideration concerns our observation in our September 30 Order that we consistently have evaluated avoided costs as of the time negotiations between the utility and the developer occur, and our holding rejecting Armco/Allegheny's argument that, as a matter of law, the agreements must be evaluated with reference to West Penn's current avoided costs. But for the Section 527 argument, *supra*, Armco/Allegheny have not raised anything not previously considered on this point. Therefore, we deny their petition for reconsideration on this point, while noting that under the terms of the September 30 Order, parties are free to argue that circumstances unique to these proceedings justify a departure from this policy in this case.

Having addresesd the various pleadings filed in response to our order of September 30, 1988; THEREFORE,

IT IS ORDERED:

1. That the proceeding at Docket No. P-870216 pertaining to the proposed power purchase agreement between West Penn Power Company and Milesburg, Inc. is consolidated with the proceedings at Docket Nos. P-880283, P-880284 and P-880286 for the purpose of hearing.

2. That the Order of September 30, 1988 and the Order of today's date are interlocutory, and all holdings set forth in these Orders will be subject to review by the filing ~~of a~~ Petition for Review upon the entry of a final Commission Order in these proceedings.

3. That the balance of the variously-styled Petitions for Reconsideration are granted or denied consistent with the foregoing opinion.

4. That a copy of this Opinion and Order be served upon all parties to above-captioned proceedings.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: January 19, 1989

ORDER ENTERED: January 19, 1989

APPENDIX I

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

P-870216; P-880283;
P-880284 & P-880286

PETITIONS OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS, RE: MILESBURG ENERGY, INC., MONONGAHELA LOCK AND DAM NO. 8, BURGETTSTOWN PROJECT AND SHANNOPIN MINE PROJECT.

ORDER

By Petition received in my office on February 10, 1989, Milesburg Energy, Inc. (MEI), pursuant to Section 508 of the Public Utility Code, 66 Pa. C.S. § 508, requests modification of an electric purchase agreement between MEI and West Penn Power Company (West Penn) 1) so that the capacity cost rates in the agreement can be recalculated to reflect a later on-line date of the cogeneration project and 2) so that the agreement's financing closing date and other milestone dates can be extended. All parties to this proceeding have been served with a copy of the Petition. The attached petition has no docket number because MEI was not sure how its petition would be docketed. Owing to the time restraints mentioned below, I am not waiting for this pleading to be docketed and sent to me from Harrisburg.

The Commission's regulations set a 20 day deadline for the filing of answers to petitions. The 20 day deadline in this proceeding will elapse *after* the current financing closing date of the agreement. Without the requested relief, the Milesburg congeneration project cannot be built. For this reason, I am issuing this order before the end of the answer period. No answers have been filed as of this date.

The reformation of the agreement to update the levelized capacity cost rates to reflect the amended on-line date of the Milesburg project is necessary because the assumptions as to the date electric energy would be delivered has been moved ahead by litigation not anticipated when the agreement was executed. The current levelized capacity rate schedule is calculated assuming an on-line date in 1989. It is obvious that the project will not be on line in 1989 and it is not in the public interest for payments to begin before the on-line date. The updated rate is a levelized rate based on the *same* assumptions as those used by West Penn in calculating the rates in the agreement.

For the above reasons, the Petition should be granted.

A copy of MEI's Petition is attached hereto.

Accordingly,

IT IS ORDERED:

1. That the February 25, 1987 contract between Milesburg Energy, Inc., and West Penn Power Company which was accepted by the Commission for filing pursuant to 52 Pa. Code § 57.32(c)(2) in an Order entered September 17, 1987 at Docket No. P-870216 is hereby amended to relieve Milesburg Energy, Inc. of the deadline of February 28, 1989 to obtain financing and all subsequent deadlines in the Agreement.

2. That the contract between Milesburg Energy, Inc. and West Penn Power Company is reformed to require Milesburg Energy, Inc. to obtain financing pursuant to the February 25, 1987 Electric Energy Purchase Agreement not later than 120 days after an Order of this Commission giving advance approval for recovery of all energy and capacity costs incurred becomes final and non-appealable. All other subsequent deadlines in the Electric Energy Purchase Agreement shall be adjusted accordingly.

3. That the contract between Milesburg and West Penn is reformed to adopt an updated capacity cost rate.

/s/ Larry Gesoff
LARRY GESOFF
Administrative Law Judge

February 21, 1989

APPENDIX J

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

P-870216; P-880283· P-880284 & P-880286

PETITIONS OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS, RE: MILESBURG ENERGY, INC., MONONGAHELA LOCK AND DAM NO. 8, BURGETTSTOWN PROJECT AND SHANNOPIN MINE PROJECT.

ORDER

The order issued by me on February 21, 1989 granting the Petition of Milesburg Energy, Inc. for Modification of an Electric Purchase Agreement is rescinded.

/s/ Larry Gesoff
LARRY GESOFF
Administrative Law Judge

February 27, 1989

APPENDIX K

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held March 30, 1989

Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice Chairman
Joseph Rhodes, Jr.
Frank Fischl, dissenting

Docket Nos. P-870216 P-880283 P-880284 P-880286

PETITIONS OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS

Re: MILESBURG ENERGY, INC.
MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

ORDER ON PETITION OF MILESBURG ENERGY, INC. FOR THE ISSUANCE OF AN INTERIM EMERGENCY ORDER OR APPEAL OF JUDGE GESOFF'S FEBRUARY 27, 1989 ORDER

Before us for consideration is the Petition of Milesburg Energy, Inc. ("MEI") for the Issuance of An Interim Emergency Order or Appeal of Judge Gesoff's February 27, 1989 Order ("emergency petition"). MEI filed the

instant petition on March 3, 1989. For the reasons stated more fully below, we will deny the request for an emergency order, but grant limited interlocutory review under 52 Pa. Code § 5.303(a)(1) by requiring all parties to maintain the status quo pending consideration of MEI's underlying petition filed February 9, 1989 under the provisions of Section 508 of the Public Utility Code, 66 Pa. C.S. § 508.

BACKGROUND

The proceedings involving MEI began on April 2, 1987, when West Penn Power Company ("West Penn") filed a petition for, *inter alia,* rate recovery approval of amounts proposed to be paid under the terms of an electric energy purchase agreement with MEI dated February 25, 1987. By Order entered September 22, 1987 the Commission granted West Penn authorization to recover amounts paid to MEI under the February 25, 1987 agreement. On appeal, the Commonwealth Court vacated our September 22, 1987 Order and remanded the matter to us for further consideration under the terms of the Court's August 22, 1988 Opinion and Order. *Barasch v. Pennsylvania Public Utility Commission,* —— Pa. Commonwealth Ct. ——, 546 A.2d 1296 (1988).

The capacity credit of 3.3 cents per Kwh in the February 25, 1987 power purchase agreement was based on, *inter alia,* commercial operation of the Milesburg Facility in 1990. One of the conditions precedent to both parties' obligations under the agreement was financial closing for the Facility on or before September 1, 1988. All parties to the Commonwealth Court proceeding were aware of the September 1, 1988 financial closing date and of the fact that financial closing could not take place in the absence of a final, nonappealable Commission Order granting rate recovery of amounts to be paid under the electric energy purchase agreement between West Penn and MEI.

MEI filed its first petition for, *inter alia*, extension of the September 1, 1988 financial closing date on August 4, 1988. Largely due to the time constraints presented by Section 508 of the Public Utility Code, 66 Pa. C.S. § 508, the Commission's staff attempted to settle the matter among all of the parties. The result was a Consent Order executed by MEI, West Penn, Armco, Inc. and Allegheny Ludlum Steel Corporation ("Armco/Allegheny"), the Office of Consumer Advocate ("OCA"), the Commission's Trial Staff ("Trial Staff"), and the West Penn Power Industrial Intervenors ("WPPII"). The Consent Order was adopted and entered by the Commission on September 1, 1988, and provided as follows:

> NOW THEREFORE, IT IS ORDERED THAT
>
> 1. The Financing Closing Date set forth in Section 10.2 of the Agreement is hereby extended to and including February 28, 1989, and any other dates, including the earliest possible Commencement Date, in the said Agreement that is dependent on the said Financing Closing Date is extended for a like period. Should the Financing Closing Date not occur on or before February 28, 1989, the Agreement will automatically terminate pursuant to Section 10.2, unless otherwise extended by further order of this Commission.
>
> 2. Any hearing held pursuant to the Order of the Commonwealth Court dated August 22, 1988 shall include the receipt of evidence related to, and an express determination of, whether and to what extent the Commission should consider a further extension of the Financing Closing Date of the Agreement beyond February 28, 1989, and any other date that is dependent on the said Financing Closing Date, as may be necessary to obtain a final, non-appealable Order of the Commission including any appeals.

3. MEI shall not seek nor be entitled to any capacity credit higher than that specified in the Agreement executed on or about February 25, 1987.

4. Any additional relief requested by MEI in its Petition is denied.

5. West Penn Industrial Intervenors shall be permitted to intervene in any Commission proceeding held in accordance with the Order of the Commonwealth Court dated August 22, 1988.

The Consent Order represented an agreement by all parties that the MEI financial closing date would be extended approximately six (6) months to February 28, 1989. Underlying the Consent Order was an unstated recognition that the six month extension probably would not be sufficient, and that the Commission's review of West Penn's rate recovery petitions at the above-docketed proceedings likely would not be concluded by a final, nonappealable Order by February 28, 1989. Essentially the Consent Order "bought time" for MEI and represented a temporary solution to an underlying problem.

With the financing date extended to February 28, 1989, MEI filed its second petition to, *inter alia*, further extend the financing date on February 9, 1989. The February 9, 1989 petition has been assigned to Administrative Law Judge ("ALJ") Gesoff, who is presiding over the above-docketed proceedings. Responsive pleadings were filed by Trial Staff, and West Penn, OCA, and Armco/Allegheny on February 23 and February 28, 1989, respectively. On March 9, 1989 MEI filed its responses to the pleadings filed by West Penn, OCA and Armco/Allegheny.

ALJ Gesoff issued an order on February 21, 1989 granting MEI's February 9, 1989 petition. At the prehearing conference for the underlying West Penn petitions held on February 27, 1989, ALJ Gesoff rescinded his February 21, 1989 Order, characterizing it as a "mis-

take" because it was issued without a hearing as required by 66 Pa.C.S. § 508. N.T. at 7.

The third petition, which is before us for review, was captioned "Petition of Milesburg Energy, Inc. for the Issuance of an Interim Emergency Order or Appeal of Judge Gesoff's February 27, 1989 Order", and was filed by MEI on March 3, 1989. MEI's third petition requests the following relief:

> MEI hereby requests that the Pennsylvania Public Utility Commission issue an interim emergency order granting MEI relief from the Financing Closing Date of February 28, 1989, as requested in its Petition of Milesburg Energy, Inc. for Modification of an Electric Power Purchase Agreement (Petition) (Attachment 1) filed with the Commission on February 8, 1989. In the alternative, MEI requests either that the Commission overturn Judge Gesoff's February 27, 1989 Order (Attachment 2) and reinstate Judge Gesoff's Order of February 21, 1989 (Attachment 3) which granted the relief requested by Milesburg in its Petition or that the Commission overturn Judge Gesoff's February 27, 1989 Order and modify the February 21, 1989 Order and remand the issues of the request for extension and rate recalculation to an administrative law judge for a hearing on the merits. For reasons explained in detail below, MEI requests only that the extension of time be addressed by this Emergency Petition.

MEI Petition of March 3, 1989 at 1.

MEI avers that, without relief, it may suffer irreparable harm and financial losses amounting to several million dollars which it will not be able to recover; that MEI will be unable to build the Milesburg Project; that granting MEI's petition for emergency relief would not be injurious to the public interest; and that extension of the financing date is a matter of the greatest importance that must be decided

by the Commission immediately. MEI Petition of March 3, 1989 at 2 and 4. MEI states as follows:

> The rescission of the Judge's Order placed MEI in an untenable position and without any relief. For example, if the Judge had initially denied MEI's Petition on February 21, 1989, MEI could have sought appeal from the Judge's Order while negotiating the issue of the extension with West Penn during the week before the contract expired. Alternatively, if the Judge had issued an *interim* order approving the extension or had set the matter for hearing, a timely resolution of the extension issue could have occurred. *Even if the Judge had simply modified his February 21, 1989 Order to require that the issues in MEI's Petition be set for hearing, again, MEI believes that a timely resolution could have been accomplished.*

MEI Petition of March 3, 1989 at 5 (emphasis supplied).

Finally, MEI argues that MEI relied upon ALJ Gesoff's February 21, 1989 Order "during the last crucial week before the Agreement terminated", and that the ALJ's rescission of his February 21, 1989 Order was a "serious error which can and should be corrected by this Commission." MEI Petition of March 3, 1989 at 6.

On March 13, 1989 West Penn filed an Answer to MEI's emergency petition. West Penn requests that the Commission deny MEI's emergency petition, and avers, *inter alia*, that the issue of the extension of the financing date is moot because the power purchase agreement automatically expired on February 28, 1989, and that the increase to the capacity credit requested by MEI in its second petition of February 9, 1989 would violate the Commission's September 1, 1988 Consent Order. On the same day that West Penn filed its Answer, it filed a Memorandum of Law in Support of its Answer, as well as a Petition for Leave to File the Memorandum of Law.

On March 13, 1989 Armco/Allegheny filed an Answer to MEI's emergency petition setting forth averments simi-

lar to those made by West Penn. By way of new matter, Armco/Allegheny argue that the Commission is powerless to modify the power purchase agreement between West Penn and MEI because it no longer exists; that there is no "clear and present danger" to MEI's life or property as contemplated by the Commission regulations at 52 Pa. Code 3.1; that MEI's emergency petition was filed under the wrong regulations; and that MEI cannot "appeal" ALJ Gesoff's February 27, 1989 Order because MEI did not file exceptions thereto. On March 15, 1989 MEI filed a Response to Armco/Allegheny's answer. In relevant part, MEI avers that, because it owns a coal plant that may not be converted to a small power production facility without a firm agreement with West Penn, MEI is in a position where it stands to lose millions of dollars unless the Commission acts immediately to rectify the situation.

On March 14, 1989 MEI filed Exceptions to Judge Gesoff's February 27, 1989 Order pursuant to 52 Pa. Code § 5.533. The cover letter accompanying the Exceptions states that "MEI does not believe that the filing of exceptions is necessary considering the fact that MEI presently has a Petition for Interim Emergency Relief pending before the Commission which incorporates these exceptions, however MEI makes this filing to assure that it has complied with all necessary Commission requirements." MEI's exceptions merely incorporate and refer to its March 3, 1989 emergency petition. On March 21, 1989 West Penn filed a Reply to MEI's exceptions, requesting that they be stricken as violative of 52 Pa. Code § 5.533.

DISCUSSION

As a preliminary matter, we will grant West Penn's Petition for Leave to File Memorandum of Law in support of its answer to MEI's emergency petition. Although our regulations governing interim emergency orders (and, by implication, emergency orders) prohibit the filing of memoranda or briefs, our regulations at 52 Pa. Code § 5.301 *et seq.* governing interlocutory review authorize

the filing of briefs within seven (7) days of service of the petition. Since MEI's emergency petition was alternatively styled as an appeal of ALJ Gesoff's February 27, 1989 Order, West Penn's memorandum of law will be allowed.

The first issue to address is the procedural status of MEI's Petition for the Issuance of an Interim Emergency Order or Appeal of Judge Gesoff's February 27, 1989 Order. MEI's emergency petition states that it was filed under 52 Pa. Code § 3.6, "Petitions for interim emergency orders." Section 3.6 authorizes the filing of petitions for interim emergency orders at any time during the pendency of a proceeding; provides that allegations contained in the petition shall be deemed denied by the opposing parties; and states that answers from opposing parties are not required. Section 3.7 permits an ALJ to issue an interim emergency order upon finding that all of the following exist: (1) the petitioner's right to relief is clear; (2) the need for relief is immediate; (3) the injury would be irreparable if relief is not granted; and (4) the relief requested is not injurious to the public interest. In addition, Section 3.7 provides that an order granting or denying interim emergency relief shall be issued within 15 days of receipt of the petition. Section 3.9 provides that no interim emergency order may be issued until the ALJ or presiding officer "holds a hearing on the merits of the petition," and requires the holding of a hearing within 10 days of the petition's filing. Finally, Section 3.10 provides for Commission review within thirty (30) days of interim emergency orders, essentially by the certification procedure at 52 Pa. Code § 5.305.

It is clear from a review of the above provisions that MEI's emergency petition, which is directed to the *Commission,* is not a petition for an "interim emergency order" under 52 Pa. Code §§ 3.6 through 3.10. These provisions set forth a very specific procedure by which a party to a proceeding can request an interim emergency order from the presiding *administrative law judge.* Because MEI's petition is addressed to the Commission, it should have

been filed pursuant to 52 Pa. Code §§ 3.2 through 3.5, which authorizes the issuance of an emergency order by the Commission. Therefore, we will consider it under these provisions.

Section 3.2 authorizes the issuance by the Commission of an emergency order in a situation where there is "an actual or declared emergency." Section 3.1 defines "emergency" in relevant part as a "situation which presents a clear and present danger to life or property." An "emergency order" is defined as an *ex parte* order issued by, *inter alia*, the Commission in response to an emergency." If the Commission issues an emergency order, Section 3.4 permits a person against whom the emergency order is issued to petition the Commission for an expedited hearing before a presiding officer within 10 days to determine whether or not the emergency order will remain in effect, with the presiding officer's recommended decision to be acted upon by the Commission at its next scheduled public meeting.

The issuance by the Commission of an emergency order is a form of relief to be sparingly utilized in only the most extraordinary circumstances, where there is "a clear and present danger to life or property". This view is supported by the Commonwealth Court's recent decision in *Peoples Natural Gas Company v. Pennsylvania Public Utility Commission* at No. 1898 C.D. 1 988 (Opinion and Order filed March 7, 1989). In *Peoples*, the Commonwealth Court held that the speculative economic threat of the loss of the proposed plant expansion in that case would not permit a finding of clear, immediate and irreparable injury required by the Commission's regulations at 52 Pa. Code § 3.7 governing the issuance of interim emergency orders. Although the instant petition must be evaluated under 52 Pa. Code §§ 3.2 through 3.6, in lieu of § 3.7, the "clear and present danger" standard of Sections 3.2 through 3.6 is at least as stringent than the "irreparable injury" standard of Section 3.7. In addition, Section 508 of the Public Utility Code, 66 Pa.C.S. § 508, authorizes the Commission

to modify contracts only *after* reasonable notice and hearing. Finally, since the February 28 financing date had passed before MEI's emergency petition was filed, the existence or nonexistence of an emergency order during the pendency of the hearing does not appear relevant. Therefore, upon consideration of these factors, we decline to grant MEI's petition of March 3, 1989 for an emergency order.

Our decision to deny MEI's request for an emergency order is influenced by the fact that MEI has been aware since September 1, 1988 of the February 28, 1989 financing deadline in its agreement with West Penn. Nevertheless, MEI waited until February 9, 1989 to file a second petition to further extend the financing deadline. Although Section 508 of the Public Utility Code, 66 Pa.C.S. § 508, authorizes the Commission to modify contractual provisions, such modifications can occur only after notice and hearing. In addition, contractual modifications ordered by the Commission take effect only after a thirty (30) day period following the Commission's Order. By waiting until February 9, 1989 to file its petition, MEI by its own actions created the "emergency" that it now seeks our intervention to correct by the issuance of an "emergency order" under 52 Pa. Code §§ 3.2 through 3.6. In our view, ALJ Gesoff's February 27, 1989 Order was not a "serious error," as it has been characterized by MEI, but the correct decision given the statutory constraints of Section 508.

Although we decline to issue the emergency order requested by MEI's March 3, 1989 petition, we note that MEI's February 9, 1989 petition requesting similar relief is still pending before ALJ Gesoff. Responsive pleadings in opposition to the petition have been filed by various parties. Although we express no opinion on the merits of MEI's February 9, 1989 petition at this time, we observe that, should MEI prevail, the electric energy purchase agreement between MEI and West Penn could be reinstated by extending the financing deadline *nunc pro tunc*,

for example by modifying the contractual provision so that it is not self-executing.

MEI's March 3, 1989 petition was styled, in the alternative, as an "appeal" of ALJ Gesoff's February 27, 1989 order. Although, in our view, ALJ Gesoff's February 27, 1989 Order was correct given the limitations of Section 508, we will grant limited interlocutory review by granting a stay of proceedings. Therefore, although we deny the March 3, 1989 petition for an emergency order, pursuant to 52 Pa. Code § 5.303(a)(1) we will require all parties to maintain the status quo with respect to the February 25, 1987 agreement pending consideration by the ALJ, and ultimately the Commission, of MEI's February 9, 1989 petition. Parenthetically we noted that it may be in the interests of West Penn and its ratepayers to retain MEI under a voluntary agreement setting forth a negotiated rate for the sale of power. Absent a negotiated rate, MEI is entitled to a capacity (and associated energy) rate determined in accordance with our regulations. A key issue of first impression would be the time frame to be utilized in determining MEI's avoided cost-based rate. Although we express no opinion on this issue at this time, our preliminary observation is that MEI's situation may be distinctly different from the situation considered by us in *Petition of Pagnotti Enterprises*, Docket No. P-870281 (August 19, 1988). In *Pagnotti*, a negotiated purchased power rate had been approved by the Commission on June 30, 1986, and our June 30, 1986 Order became final and nonappealable on July 30, 1986. The project participants in that proceeding failed to meet, in large part, an agreed-upon financing deadline of December 31, 1986, which occurred approximately five (5) months after the issuance of the final, nonappealable order that is necessary for a project's financing. We found in *Pagnotti* that, by missing the financing deadline, the project participants had waived their entitlement to rates based on Pennsyl-

vania Power & Light Company's ("PP&L's") avoided cost projections as of the time that serious negotiations took place, and that the project therefore was entitled to rates based on PP&L's avoided costs projections as of January 1, 1987. In the instant proceeding, MEI has never been the beneficiary of a final, nonappealable Commission Order approving rate recovery of amounts proposed to be paid by West Penn. In fact, MEI's agreement with West Penn has been before the Commission and/or the Commonwealth Court for nearly two years. Without a final nonappealable Commission Order, a project such as MEI's cannot receive financing. Therefore, it may be that, if asked to rule upon this issue of first impression in Pennsylvania, we may determine that MEI has not waived its entitlement to rates based on West Penn's avoided costs as of the time that serious negotiations between West Penn and MEI took place; THEREFORE,

IT IS ORDERED:

1. That West Penn Power Company's ("West Penn's") March 13, 1989 Petition for Leave To File a Memorandum of Law is granted.

2. That the March 13, 1989 Petition of Milesburg Energy, Inc. ("MEI") for the Issuance of an Interim Emergency Order is denied.

3. That MEI's March 3, 1989 Appeal of Judge Gesoff's February 27, 1989 Order is granted to the extent that all parties are directed to maintain the status quo with respect to the February 25, 1987 power purchase agreement between West Penn and MEI pending consideration by the Commission of MEI's February 9, 1989 petition currently pending before Administrative Law Judge Gesoff.

4. That a copy of this Order be entered and served upon all parties to the above-captioned proceedings on or before April 3, 1989.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: March 30, 1989

ORDERED ENTERED: March 31, 1989

APPENDIX L

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Docket Nos. P-870216
P-880283
P-880284
P-880286

PETITION OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS

RE: MILESBURG ENERGY, INC.
MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

RECOMMENDED DECISION

Before
Larry Gesoff
Administrative Law Judge

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I. HISTORY OF THE PROCEEDINGS

On April 2, 1987 West Penn Power Company (WPP) filed a Petition for approval of an Electric Energy Purchase Agreement (EEPA) between it and Milesburg Energy, Inc. (MEI) and for advance approval for recovery through its energy cost rate (ECR) of all energy and capacity costs incurred under the EEPA. The Office of Trial Staff (OTS) and the Office of Consumer Advocate (OCA) filed answers to the Petition and Armco, Inc. and Allegheny Ludlum Corporation (AAL) jointly filed a Petition to Intervene and a Motion to Dismiss the WPP Petition. MEI intervened in support of the WPP Petition and filed responses to the pleadings of OTS, OCA and AAL.

On September 22, 1987, the Commission, without a hearing, entered an order accepting the WPP/MEI EEPA for filing under 52 Pa. Code § 57.32(c)(2)[1], determining that the EEPA was in the public interest, authorizing ECR recovery of expenses paid by WPP to MEI under the EEPA, and declaring that it will not consider additional generation capacity resulting from the EEPA in determining the reserve margins or economic benefits resulting from any base load or other generating unit during the term of the contract.

On October 9, 1987 WPP filed a petition for reconsideration of the Commission's Order entered September 22, 1987, requesting that the Commission publish its Order in the *Pennsylvania Bulletin* so that WPP's ratepayers would receive notice of the pass through to them of the capacity and energy charges incurred by WPP during the

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[1] 52 Pa. Code §§ 57.31-57.39 contain the Commission's regulations governing the purchase and sale of energy and capacity between electric utilities and qualifying facilities (QF's) pursuant to Section 210 of the Public Utility Regulatory Policies Act (PURPA) 16 U.S.C. § 824a-3(a)-(j), and regulations promulgated thereunder at 18 C.F.R. §§ 292.101 *et seq.*

30 year duration of the EEPA.[2] On or about October 6, 1987, OCA petitioned the Commission to clarify and reconsider its Order entered September 22, 1987, specifically requesting that the Commission 1) clarify that its approval of the WPP/MEI EEPA has no impact on the base rate proceedings at Docket No. R-850220 (in which, at the time, excess capacity was being addressed on reconsideration on WPP's sought recovery of costs related to the Bath County pumped storage project (Bath County)), 2) clarify that the Order makes no findings regarding WPP's then present capacity situation, and 3) not apply its proposed policy statement on Section 1323 of the Public Utility Code (Code), 66 Pa. C.S. § 1323.[3] On or about October 6, 1987, AAL filed a Petition for reconsideration of the September 22, 1987 Order contending, among other things, that it was entered without a due process mandated hearing. WPP replied to the petitions of OCA and AAL.

By a vote of two to two at a public meeting held October 22, 1987, the Commission declined to grant reconsideration. WPP, OCA and AAL appealed separately from the Commission's September 22, 1987 Order and the Pennsylvania Commonwealth Court (Commonwealth

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[2] In its original Petition, WPP requested that the Commission issue a declaratory order and publish it for public comment in the *Pennsylvania Bulletin*, but the Commission's Order did not so provide.

[3] Section 1323 provides for certain disallowances if the Commission finds that a utility has excess capacity as the result of claiming costs, for the first time, of an electric generating unit in its rates. Section 1323(c) creates an exception for certain cogeneration projects affecting the excess capacity analysis of certain baseload plants. The Commission's proposed policy statement regarding the treatment of purchases of capacity from QF's in excess capacity determinations was published for comment in the *Pennsylvania Bulletin* of July 18, 1987. Comments have been filed (at Docket No. L-870030), but as of this writing no action has been taken.

Court) consolidated the appeals. *Barasch, et al. v. Pennsylvania Public Utility Commission*, Nos. 2418, 2499 and 2522, C.D. 1987.

On December 31, 1987, January 5, 1988 and January 20, 1988, WPP filed petitions requesting approval of rate recovery of amounts paid pursuant to EEPAs with the developers of the Monongahela Lock and Dam No. 8 Project (Monongahela Project), the Burgettstown Project and the Shannopin Mine Project, respectively. In its petitions, as in the MEI petition, WPP requested ECR pass through, public notice and a comment period, and a finding of no excess capacity under Section 1323. OCA filed answers to all three petitions; Airco Industrial Gases filed petitions to intervene in all three petitions, but filed no answers; and AAL filed petitions to intervene in all three petitions, but filed answers only to the Burgettstown and Shannopin Mine Project. North Branch Energy Partners, L.P. (North Branch), the developer of the Burgettstown Project filed a petition to intervene in the proceeding at P-880284 and a statement in support of WPP's petition. Mon Valley Energy Corporation (Mon Valley), developer of the Shannopin Mine Project filed a petition to intervene in the proceeding at P-880286. WPP filed replies to the answers of OCA and AAL. North Branch filed responses to the answers of AAL and OCA to WPP's Burgettstown Project petitions. Mon Valley filed responses to the answers of AAL and OCA to the Shannopin Mine Project petitions. AAL filed a reply to the response of North Branch to AAL's answer to the Burgettstown Project petition.

The Commission, without a hearing, by Tentative Opinion and Order entered July 8, 1988, among other things, 1) granted all petitions to intervene, 2) approved the rates in all three EEPAs as just, reasonable and in the public interest, 3) authorized ECR recovery of all costs paid under the EEPAs, 4) declared that the capacity represented by the projects does not represent excess capacity

as to the capacity itself or as to any existing WPP capacity, 5) provided for publication of notice of the Tentative Opinion and Order in the *Pennsylvania Bulletin*, and 6) provided that the Tentative Opinion and Order would become final absent the filing of exceptions within 30 days of publication of the notice. Timely exceptions were filed by Mr. F. Alan Sever, the West Penn Power Industrial Intervenors (WPPII),[4] OCA, WPP, and AAL. WPP filed replies to the exceptions of WPPII, OCA and AAL.

After the Commission entered its Tentative Opinion and Order, Commonwealth Court on August 22, 1988, vacated the Commission's Order of September 22, 1987 (approving the WPP/MEI EEPA at Docket No. P-870216) and remanded the proceeding for Commission reconsideration of its declaration that the capacity credit proposed to be paid to MEI was in the public interest, and its declaration that it will not consider the capacity represented by the Milesburg Project in future West Penn excess capacity determinations. *Barasch, et al. v. Pennsylvania Public Utility Commission*, 119 Pa. Commw. 81, 546 A.2d 1296 (1988) (*Milesburg*). The Commonwealth Court concluded that the capacity credit proposed to be paid to MEI involved substantial property interests of WPP's ratepayers, and that these interests, in combination with the adjudicatory nature of the Commission's September 22, 1987 Order, required that ratepayers must be afforded due process. *Milesburg* at 1305. Accordingly, the Court held that, since payments for capacity were involved, the Commission should require West Penn to provide notice to its customers "in a manner consistent with that prescribed in 52 Pa. Code § 53.45(a), allowing for bill inserts in lieu of mailed or hand delivered individual notices." *Milesburg* at 1308. With regard to the opportunity to be heard, the Court held that "the [C]ommission

[4] In these proceedings, the WPPII group is comprised of Airco Industrial Gases, Latrobe Steel Co., PPG Industries, Inc. and Powder Metal Products, Inc.

must devise a procedure that provides the *essential elements of a hearing*, but allows for consideration of petitions of the type involved here *in as expeditious and minimally burdensome a manner as possible*." *Milesburg* at 1307. (emphasis supplied)

In response to *Milesburg*, by Order entered September 30, 1988, the Commission consolidated the Monongahela, Burgettstown and Shannopin petitions and assigned them to the Office of Administrative Law Judge for hearing and recommended decision. WPP was directed to notify its customers of the three petitions by bill insert.

In the body of its Order, the Commission included two observations regarding the proper scope of the hearing. These are noted in some detail here because they provide a preliminary statement of some of the issues in these proceedings. The following contains part of the Commission's first observation:

> The Commonwealth Court has *not* imposed upon the Commission a requirement that petitions of the type involved here be subjected to an exhaustive proceeding in the nature of a general rate increase proceeding under Section 1308(d) of the Public Utility Code, 66 Pa.C.S. § 1308(d). Accordingly, we will direct the OALJ to limit the scope of discovery, the admission of testimony and evidence; and the cross-examination of testimony to issues that are relevant to our consideration of West Penn's petitions. In our view, the fundamental factual issue to be resolved is whether the proposed rates are at or below West Penn's full avoided costs as defined by our regulations at 52 Pa. Code § 57.31 *et. seq.* If the rates are at or below the rates to which the developers would be entitled as a matter of law, the rates are *per se* reasonable and automatically are recoverable from ratepayers. As we stated in our Tentative Opinion and Order, "the heart of the matter really is whether

> West Penn's projection of a need for capacity at the time that the three agreements were being negotiated was reasonable. If so, the payment of a capacity credit to the various developers is required by law." Tentative Opinion and Order at 22-23. An examination of this ultimate factual issue to be resolved will include an examination of several sub-issues of fact, including but not limited to projections of West Penn's installed capacity and customer demand. With respect to the appropriate reserve margin for West Penn, our Tentative Opinion and Order relied upon the two prior litigated Bath County proceedings at Docket Nos. R-842632 and R-850220 where we found the optimum reserve margin for West Penn was 28 percent. West Penn's projected need for capacity in the instant proceedings was based on a *lower* planning reserve margin of 25%. OCA's Exceptions to the Tentative Opinion and Order argue, *inter alia*, that the doctrine of collateral estoppel should not be applied to our prior findings on West Penn's appropriate reserve margins. We will leave the issue of whether collateral estoppel is properly applicable to our prior findings to the ALJ for his/her consideration and recommendation. (Mimeo at 3-4).

The Commission also rejects AAL's contention that as a matter of law the EEPAs must be evaluated with reference to WPP's current avoided costs as opposed to the time during which serious negotiations take place, which is the Commission's policy. The Commission, however, "leave[s] the issue of whether or not to consider arguments for a change in policy to the ALJ's discretion." Mimeo at 5. Finally, in its first observation, the Commission, noting that Commonwealth Court affirmed the Commission's policy of approving of levelized payments in agreements (including capacity payments before the date a utility projects a need for capacity), directs the ALJ to exclude the

issue of timing and of "inter-generational" inequity from the scope of the proceeding.

The Commission's second observation addresses the desirability to consolidate the Milesburg petition with the other three petitions. This was not possible at the time because the remand of the Milesburg record was stayed by applications for re-argument of the appeal. The Commission directed WPP to include the filing of the Milesburg petition in the same bill insert to facilitate future consolidation of all four proceedings. Finally, the Commission directed its advisory staff to calculate an estimated capacity credit to which the various developers would have been entitled under the Commission's regulations and to supply the calculations to the ALJ and the parties before the start of evidentiary hearings.

By Order entered October 27, 1988, the Commission responded to variously styled petitions for reconsideration of its September 30, 1988 Order filed by WPPII, AAL, North Branch and WPP. The Order grants reconsideration pending further consideration of the merits of the pleadings.

On January 19, 1989 the Commission entered its Opinion and Order on Reconsideration. In it the Commission notes that on November 3, 1988 the Commonwealth Court filed its opinion and order in *Milesburg*, among other things, holding that the Court's August 22, 1988 decision shall not be retroactive and shall apply only to the Milesburg petition and to petitions filed after August 22, 1988. Even so, the Commission voluntarily applied *Milesburg* to the Monongahela, Burgettstown and Shannopin petitions and consolidated all four proceedings for hearing and recommended decision. The Commission also directed that its Order of September 30, 1988 and the Order under discussion here (entered January 19, 1989) are interlocutory and that all holdings therein are subject to appellate review following entry of the Commission's final order. The Commission left to the assigned ALJ the

decision whether to grant WPP's request for a trial type hearing. While it did not set a firm deadline for the issuance of a Recommended Decision, the Commission requested that it be issued within two to three weeks after main briefs are filed, and suggested that the filing of reply briefs be eliminated.[5]

Also in the January 19, 1989 order, the Commission again rejects AAL's position on levelized rates and the time frame for determining avoided costs. In a slight change from its September 30, 1988 Order, the Commission stated that the "parties are free to argue that *circumstances unique to these proceedings* justify a departure from this [the Commission's time frame] policy in this case." Mimeo at 7. Also the Commission rejects AAL's argument under Section 527 of the Public Utility Code, 66 Pa. C.S. § 527. AAL asserts that because Section 527 directs the Commission to require that utility rates reflect savings to the utility from cogeneration, the Commission is prohibited from using its regulations as a benchmark for determining the reasonableness of rates paid to QF's. Mimeo at 6.

On August 4, 1988, while the *Milesburg* decision was pending, MEI filed a petition requesting 1) that a Commission investigation be opened, 2) that its EEPA with WPP be modified, and 3) that until further Commission Order, WPP be prohibited from constructing any generating unit whose construction would have been deferred by electricity purchases under the MEI/WPP EEPA. The contract modification sought is a two-fold reformation. First, MEI would be relieved of the September 1, 1988 deadline to obtain financing and all subsequent deadlines in the EEPA. Second, the contract would be reformed to require MEI to obtain financing under the EEPA not later than ninety days after a Commission order giving ad-

[5] As will be seen, the unforseen contingencies referenced in the Commission's order made it impossible to meet the Commission's requested schedule.

vance approval for recovery of all energy and capacity costs incurred becomes final and non-appealable. All other subsequent deadlines in the EEPA would be adjusted accordingly. This reformation was requested because Section 10.2 of the EEPA provided that if MEI did not obtain financing by September 1, 1988, the EEPA would terminate automatically. OTS, AAL, WPP, and OCA filed various styled responsive pleadings to MEI's Petition and MEI replied jointly to all four responses.

Reformation of a contract under Section 508 of the Public Utility Code, 66 Pa. C.S. § 508 does not become effective until 30 days of service of the Commission's reformation order, which itself must be preceded by notice and hearing. Because MEI's reformation petition was filed less than 30 days before the financing deadline, Section 508 was not available. For this reason, by Consent Order dated August 31, 1988, adopted by the Commission on September 1, 1988, the parties agreed to extend the financing closing date to February 28, 1988 and extend other dates accordingly. The automatic termination clause of Section 10.2 was maintained, subject to extension by further order of the Commission. The consent order also provided that "MEI shall not seek nor be entitled to any capacity credit higher than that specified in the agreement executed on or about February 25, 1987." AAL Ex. 80.

On January 10, 1989, WPP submitted to the Commission an affidavit verifying that the bill inserts referenced in the Commission's Order of September 30, 1988 had been served upon its customers beginning on October 21, 1988. The Affidavit also verifies that notices containing the same language were posted in WPP offices and collection agencies and appeared in newspaper advertisements and news releases.

On February 10, 1989, MEI filed another petition to modify its EEPA with WPP 1) to recalculate the capacity costs to reflect a later on-line date of the project and 2)

to extend the financing closing date and other milestone dates. (MEI's Second Petition for Modification) By Order dated February 21, 1989, without waiting for responses and without holding a Section 508 reformation hearing, I granted the relief requested because the financing closing date was due to elapse on February 28, 1989. By order dated February 27, 1989, I rescinded my order of February 21, 1989.

At the prehearing conference held on February 27, 1989 I gave the reasons for my rescission order. In brief, my February 21, 1989 order was in error because there was no hearing and because even if a Commission order reforming the contract was entered on the day the petition was filed, it would not become effective under Section 508 until *after* the financing deadline elapsed.

On March 3, 1989, MEI filed a Petition for Emergency Order or Appeal of Judge Gesoff's February 27, 1989 order. By Order entered March 31, 1989, the Commission denied the request for an emergency order but required all parties to maintain the status quo pending consideration of MEI's Second Petition for Modification. MEI also filed exceptions to my February 27, 1989 order.

On March 15, 1989 WPP filed a Petition for leave to withdraw its Petition for approval of the MEI EEPA (WPP's Withdrawal Petition) on the grounds that the issues in the proceeding have been rendered moot as the EEPA terminated automatically by its own terms. MEI filed an answer to WPP's Withdrawal Petition; WPPII filed a statement in support of the petition; and MEI filed a response to WPPII's statement.

On March 22, 1989, AAL filed a Motion to dismiss WPP's MEI EEPA petition on the grounds that WPP's EEPA with MEI no longer exists. MEI responded with a pleading, styled as a preliminary motion and answer, requesting that AAL's motion to dismiss be denied. WPP filed an answer to MEI's Motion.

On April 3, 1989, North Branch filed a petition requesting modification of its EEPA with WPP (the Burgettstown Project) to change the Financing Closing Date, currently October 1, 1989, to be six months from the date of the Commission's final order; to extend the Commencement Date and adjust all other dates accordingly; and to modify the capacity credit to reflect the modified project in service date. AAL, OCA and WPP filed answers to the petition.

MEI's Second Petition for Modification, WPP's Withdrawal Petition, AAL's Motion to Dismiss, and North Branch's Petition were litigated during Phase Two of these proceedings. Phase One consists of the hearing on the merits of WPP's petitions for approval of the four EEPAs.

As noted, the prehearing conference in this proceeding occurred on February 27, 1985. During the prehearing conference, I granted the motions of OCA, AAL, WPPII and North Branch to compel answers to interrogatories. This necessitated a ruling that the Commission's approval of WPP's reserve margin in two previous base rate proceedings concerning Bath County (R-850220 and R-842632) would not preclude reserve margin as an issue in this proceeding. See pages 19 and 20 of the transcript of the prehearing conference. Also, requests for depositions were granted, the request of the developer of the Monongahela Project to sever its petition (P-880283) was denied, and a schedule for the submission of pre-filed direct testimony, for the hearing and for briefs as set.

A trial type hearing was held. Eight days of hearing, from April 3 to April 12, 1989, produced 1475 pages of transcript. Twenty different witnesses testified, and 28 Statements and 162 Exhibits were admitted into the record. The parties litigating this proceeding—WPP, MEI, North Branch, Mon Valley, AAL, WPPII and OCA (neither OTS nor the Monongahela Project developer partici-

pated)—filed Main Briefs on May 16, 1989 and Reply Briefs on May 31, 1989.[6]

On May 12, 1989, MEI filed a Petition to Modify its petition to modify its EEPA. WPP and ALL filed answers.

The reader is directed to the tables appearing at the end of WPP's Main Brief. The tables list each witness and the statements and exhibits they sponsored. This is necessary since exhibits premarked by the parties with a witness's initials were changed so that each party's exhibits are numbered sequentially; the text of the statements referring to the exhibits was not changed, however, and the table is provided to help the reader locate the correct exhibit.

As can be determined by this history and by what follows, it was not possible for these proceedings to provide "the essential elements of a hearing" while allowing for Commission consideration "in as expeditious and minimally burdensome a manner as possible." *Milesburg* at 1307. Nor was it possible to adhere to the Commission's suggested timetable. It is hoped, however, that the Commission can devise a speedier, less burdensome proceeding for future utility/QF petitions while still preserving due process rights for all parties. This is necessary, in my opinion, to prevent Pennsylvania from being a hostile enviroment for future QF projects. The nature of these proceedings, therefore, should not be viewed by potential QF's, QF developers and other interested entities as a model for future proceedings.

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[6] MEI, North Branch and Mon Valley submitted joint briefs which address common and individual interests. The Projects sponsored some witnesses and exhibits separately and some jointly. The joint briefs shall be referred to as BM&S Main Brief and BM&S Reply Brief. At times the three projects are referred to jointly as the Projects and sometimes individually, e.g., the Shannopin Project. Also the projects are sometimes referred to by project name and sometimes by developer name.

II. THE PROJECTS AND THE EEPAs

A. *The Milesburg Project*

This project is being developed and, if approved, will be operated by MEI which is owned by the Environmental Power Corporation. MEI St. 1 at 1.

The project will have a circulating fluidized bed boiler facility designed to burn bituminous coal refuse, to be located at the retired Milesburg Power Station in Milesburg, Centre County, Pennsylvania, previously operated by WPP and now owned by MEI. As a condition precedent to WPP's obligation to purchase capacity or energy from MEI, MEI must receive an Order from the Federal Energy Regulatory Commission (FERC), certifying that the Project is a QF under PURPA and the FERC regulations implementing PURPA.

The Project is expected to generate energy at an average rate in the range of 36.5 to 43 megawatthours per hour. The maximum installed capacity of the Project will be 43 megawatts. (The anticipated energy generation and capacity are subject to further revision pending final design.) The Project is located with WPP's service territory and power from the Project will be delivered by direct interconnection with the WPP system.

MEI and WPP executed an EEPA dated February 25, 1987, concerning the terms and conditions on which MEI will sell and West Penn will purchase power from the Project. A copy of the EEPA appears in this record as AAL Exhibit 11. In general, the EEPA provides for the sale by MEI and the purchase by WPP of all energy and capacity produced by the Project for a term commencing on or after January 1, 1990, and extending until the thirtieth anniversary of the Project's Commencement Date (as defined in the Agreement). The purchase price for such power consists of an energy component and, after the Project's Commencement Date, a capacity component.

The energy cost, as set forth in Section 1.2 of the EEPA, is a variable rate equal to WPP's Avoided Energy Cost Rate as defined in the EEPA. This rate will be based on West Penn's actual production costs at designated power generating facilities.

As set forth in Section 1.2 and 9.1 of the EEPA, after the Commencement Date a capacity cost will be paid at a fixed rate of 3.3¢/Kwh. According to WPP, this capacity cost is essentially equal to its estimate of its levelized present value of avoided capacity over the life of the Project as of May 27, 1986. WPP's methodology in determining its estimate of its levelized present value of avoided capacity is as set forth in Exhibit 2 attached to WPP's Petition for Approval of the EEPA.

WPP will retain a mortgage and security interest in all real and tangible personal property of the Project and a security interest in all intangible personal property of the Project, subject only to the liens, charges and encumbrances securing the Project debt or otherwise approved by WPP as set forth in Section 2.4 of the EEPA.

The pricing provisions of the EEPA are based on the long term estimated avoided capacity and energy costs of the Allegheny Power System (APS), of which WPP is a member company.

The capacity costs to be paid to MEI are levelized over the Project term. This levelization of capacity costs provides MEI with an up front revenue stream sufficient to cover Project debt service, as well as operation and maintenance expenses, during the initial portion of the Agreement by fixing the Project revenues at a rate higher than current actual avoided cost, since the capacity is not estimated to be needed until 1995. However, over the life of the Project, the present value of the capacity payments to MEI is designed to equal WPP's estimate of the present value of the capacity assumed to be delayed or avoided.

EEPA is subject to certain conditions precedent, including securing a final order from the Commission, satisfactory to WPP, allowing WPP a full and timely pass through to its ratepayers, via its ECR, of all charges payable by WPP under the EEPA. As a further condition precedent to WPP's obligation to purchase capacity or energy from the Project, MEI must execute an agreement to purchase the Milesburg Power Station pursuant to stated terms and conditions satisfactory to WPP. As noted above, MEI has purchased the power station.

B. *The Monongahela Project*

This project is being developed by the Noah Corporation (Noah), a South Carolina corporation.

Noah has applied for a FERC license to operate a hydroelectric generating station at Lock & Dam No. 8 on the Monongahela River located near Point Marion in Fayette County, Pennsylvania. As a condition precedent to WPP's obligation to purchase energy and capacity under the Agreement, such FERC license must be issued no later than January 1, 1990. The Borough of Point Marion has also received an Order from FERC, issued April 3, 1986 at Docket No. QF86-413-000, certifying that the Project is a qualifying facility (QF) under PURPA and FERC regulations implementing PURPA. This FERC certification will be transferred or assigned to Noah no later than January 1, 1990.

At current annual mean river flow and at the expected average operating head, it is anticipated that the Project will generate energy at an average rate in the range of 17,100 to 20,900 megawatthours per year at a maximum gross design capacity of 5.0 megawatts. (The anticipated energy generation and capacity are subject to further revision pending final design.) The Project is located within WPP's service territory and power from the Project will

be delivered by direct interconnection with the WPP system.

Noah and West Penn executed an EEPA dated June 15, 1987, concerning the terms and conditions under which Noah will sell and WPP will purchase power from the Project. The EEPA appears in this record as WPP Exhibit 15. In general, the EEPA provides for the sale by Noah and the purchase by WPP of all energy produced by the Project for a term commencing on or after October 1, 1991, and all energy and capacity produced by the Project for a term commencing on or after January 1, 1992. The purchase price for such power consists of an energy component and, after the Project's Commencement Date (as defined in the EEPA), a capacity component.

The energy cost is a variable rate determined as set forth in Section 1.2(a) of the EEPA and, following the Commencement Date, in Section 1.2(b) and Exhibit A to the EEPA. Before the Commencement Date the purchase price for Project energy delivered to WPP shall be based on West Penn's fuel and maintenance expenses as shown in FERC Accounts 501 and 510-514.

After the Commencement Date, the energy cost for the first fifteen years is 3.8¢/Kwh unless the "Tracking Account," as provided for in Section 1.3 of the EEPA, is zero; thereafter (or during any time during the first fifteen years when the Tracking Account is zero) the energy cost varies depending upon the formula set forth in Exhibit A but will not exceed WPP's avoided energy costs as defined in the EEPA, unless such avoided energy costs are below 3.8¢/Kwh.

As set forth in Section 1.2(b) and 9.1 of the EEPA, after the Commencement Date a capacity cost will be paid at a fixed rate of 3.6¢/Kwh, based on an in-service date of the avoided capacity in 1995.

It is expected that in the early years of the EEPA WPP's payments for energy will exceed its avoided costs for energy. Therefore, the EEPA in Section 1.3 provides for a "Tracking Account" which will keep track of any energy cost payments over avoided energy costs. After the fifteenth year, the balance in the Tracking Account which is excess over avoided costs will be utilized in the form of credits against required payments. As of April 18, 1985, the date when WPP delivered its formal quotation to Noah, it was expected that any balance in the Tracking Account would be exhausted by about the end of the twenty-sixth year of the Agreement. Based on WPP's fuel cost projections as of the date of Execution of the EEPA, which are subject to change, it was expected that the Tracking Account will be exhausted by the end of the forty-third year of the Agreement. If the Tracking Account is exhausted during the Project term, WPP will thereafter pay an energy cost of 3.8¢/Kwh plus one-half the difference of the avoided energy costs over 3.8 cents per kilowatthour.

The capacity cost of 3.6¢ Kwh is approximately equivalent to WPP's estimate, as of April 18, 1985, of its levelized present value of avoided capacity over the life of the Project. WPP's methodology in determining this estimate is set forth in Exhibit 2 to WPP's Petition for approval of the EEPA.

To protect its interest in the Project, WPP will be given a mortgage and security interest in all real and tangible personal property of the Project and a security interest in all intangible personal property of the Project, including the FERC license, subject only to the liens, charges and encumbrances securing the Project debt or otherwise approved by WPP.

The pricing provisions of the EEPA are based on the long term estimated avoided capacity and energy costs, as of April 18, 1985, of APS, of which WPP is a member company.

The capacity costs to be paid to Noah are levelized over the Project term. The energy costs to be paid to Noah are front loaded. West Penn has not utilized front loaded energy payments in PURPA negotiations except for hydroelectric projects.

The levelization of capacity costs and the front loading of energy costs provides Noah with an up front revenue stream sufficient to cover Project debt service, as well as operation and maintenance, during the initial portion of the Agreement by fixing the Project revenues at a rate higher than current actual avoided cost. The payback of the levelized capacity costs to utility ratepayers occurs in the later Project years the levelization begins to result in actual payments becoming lower than the projected avoided costs at such time.

For hydroelectric PURPA Projects, the energy costs exceeding avoided costs are recorded in a "Tracking Account" and may be recaptured in later years when avoided energy costs presumably will rise.

The EEPA is subject to certain conditions precedent, including securing a final order from the Commission, satisfactory to WPP, allowing WPP a full and timely pass through to its ratepayers, via its ECR, of all charges payable by WPP under the EEPA for the life of the EEPA. As further conditions precedent, the Project's FERC license must be issued no later than January 1, 1990 and the Financing Closing Date, (as defined in the EEPA) must occur on or before July 1, 1990.

C. *The Burgettstown Project*

This project is being developed by North Branch Energy Partners, L.P. (North Branch) whose offices are in Greensburg, Pennsylvania. The General partner of North Branch is North Branch Energy, Inc., a Pennsylvania corporation with its principal place of business in Greensburg, Pennsylvania.

The project will consist of a coal-fired cogeneration plant with two circulating fluidized bed boilers, one steam turbine generator and related facilities, to be located in Robinson Township, Washington County, Pennsylvania, approximately 9 miles northeast from Burgettstown, Pennsylvania. As a condition precedent to WPP's obligation to purchase capacity or energy from North Branch, North Branch must receive a FERC order certifying that the Project is a QF under PURPA and the FERC regulations implementing PURPA.

It is anticipated that the Project will generate energy at an average rate of 91 megawatthours per hour. While the maximum Contract Output (as defined in the EEPA) is equal to 80 megawatts, the gross design capacity of the Project will be approximately 91 megawatts. (The anticipated energy generation and capacity are subject to further revision pending final design.) The Project is located within WPP's service territory and power from the Project will be delivered by direct interconnection with the WPP system. In addition, the project will be fully dispatchable by WPP.

North Branch and WPP have executed an EEPA dated October 15, 1987, concerning the terms and conditions on which North Branch will sell and WPP will purchase power from the Project. A copy of the Agreement appears in this record as AAL Exhibit 24. In general, the EEPA provides for the sale by North Branch and the purchase by WPP of energy and/or energy and capacity produced by the Project beginning on or after April 1, 1991 and extending until the thirty-third anniversary of the Project's Commencement Date (as defined in the EEPA). The purchase price for such power consists of an energy component and, after September 30, 1991, upon the occurrence of certain conditions set forth in Section 1.2 of the EEPA, 50 percent of the Capacity Cost Rate (as defined in the EEPA) for the Contract Output (as defined in the EEPA). After the Project's

Commencement Date, a capacity component equal to the Capacity Cost Rate for the Contract Output will be included in the purchase price.

The energy cost, as set forth in Section 1.2 of the EEPA, is a variable rate equal to WPP's Avoided Energy Cost Rate as defined in the EEPA. This rate will be based on WPP's actual production costs at designated power generating facilities.

As set forth in Section 1.2 and 9.1 of the EEPA, after the Commencement Date a capacity cost will be paid at a fixed rate of 3.6 cents per kilowatthour, based on an in-service date of the avoided capacity in 1995.

The capacity cost of 3.6¢/Kwh is slightly lower than West Penn's estimate of its levelized present value of avoided capacity over the life of the Project as of October 6, 1986. WWP's method in determining its estimate of its levelized present value of avoided capacity is as set forth in Exhibit 2 to WPP's Petition for approval of the EEPA.

To protect its interest in the Project, WPP will retain a mortgage and security interest in all real and tangible personal property of the Project and a security interest in all intangible personal property of the Project, subject only to the liens, charges and encumbrances securing the Project debt or otherwise approved by WPP as set forth in Section 2.4 of the EEPA.

The pricing provisions of the EEPA are based on the long term estimated avoided capacity and energy costs of APS, of which WPP is a member company.

The capacity costs to be paid to North Branch are levelized over the Project term. The levelization of capacity costs provides North Branch with an up front revenue stream designed to be sufficient to cover Project debt service, as well as operation and maintenance expenses, during the initial portion of the EEPA by fixing the Project revenues at a rate higher than current actual avoided

cost, since the capacity is not estimated to be needed until 1995. However, over the life of the Project, the present value of the capacity payments to North Branch should essentially equal WPP's estimate of the present value of the capacity assumed to be delayed or avoided.

The EEPA is subject to certain conditions precedent, including securing a final order from the Commission, satisfactory to WPP, allowing WPP a full and timely pass through to its ratepayers, via its ECR, of all charges payable by WPP under the Agreement.

West Penn intends to treat purchases from the Project as interchange purchases allocable solely to Pennsylvania.

D. *The Shannopin Mine Project*

This project is being developed by Mon Valley Energy Corporation (Mon Valley). Mon Valley is a Pennsylvania corporation with its principal office in Pittsburgh, Pennsylvania.

The Project will consist of a coal-fired cogeneration plant with a circulating fludized bed boiler and related facilities, to be located at Poland Mines, in Greene County, Pennsylvania. As a condition precedent to WPP's obligation to purchase capacity or energy from Mon Valley, Mon Valley must receive a FERC order certifying that the Project is a QF under PURPA and the FERC regulations implementing PURPA.

While the maximum Contract Output (as defined in the EEPA), is equal to 80 megawatts, the gross design capacity of the Project will be approximately 89 megawatts. (The anticipated energy generation and capacity are subject to further revision pending final design.) The project is located within WPP's service territory and power from the Project will be delivered by direct interconnection with the WPP system. In addition, the Project will be dispatchable by WPP.

Mon Valley and WPP executed an Electric Energy Purchase Agreement dated October 15, 1987, concerning the terms and conditions on which Mon Valley will sell and WPP will purchase power from the Project. A copy of the EEPA appears in this record as AAL Exhibit 40. In general, the EEPA provides for the sale by Mon Valley and the purchase by WPP of energy and/or energy and capacity produced by the Project beginning on or after March 1, 1992 and extending until the thirtieth anniversary of the Project's Commencement Date (as defined in the EEPA). The purchase price for such power consists of an energy component and, after August 31, 1992 and before the Commencement Date, upon the occurrence of certain conditions set forth in Section 1.2 of the EEPA, 50 percent of the Capacity Cost Rate (as defined in the EEPA) for the Contract Output (as defined in the EEPA). After the Project's Commencement Date, a capacity component equal to the Capacity Cost Rate for deliveries up to the Contract Output will be included in the purchase price.

The energy cost, as set forth in Section 1.2 of the EEPA, is a variable rate equal to WPP's Avoided Energy Cost Rate as defined in the EEPA. This rate will be based on WPP's actual production costs at designated power generating facilities.

As set forth in Section 1.2 and 9.1 of the EEPA, after the Commencement Date the Capacity Cost Rate will be a fixed rate of 4.0 cents per kilowatthour, based on an in-service date of the avoided capacity in 1995.

The Capacity Cost Rate of 4.0¢/Kwh is slightly lower than WPP's estimate of its levelized present value of avoided capacity over the life of the Project as of September 1986. WPP's methodology in determining its estimate of its levelized present value of avoided capacity is as set forth in Exhibit 2 to WPP's petition for approval of the EEPA.

To protect its interest in the Project, WPP will retain a mortgage and security interest in all real and tangible personal property of the Project, and a security interest in all intangible personal property of the Project, subject only to the liens, charges and encumbrances securing the Project debt or otherwise approved by WPP as set forth in Section 2.4 of the EEPA.

The pricing provisions of the EEPA are based on the long term estimated avoided capacity costs and the actual energy costs of specified generating units of APS, of which WPP is a member company.

The Capacity Cost Rate to be paid to Mon Valley is levelized over the Project term. The levelization of the Capacity Cost Rate provides Mon Valley with an up front revenue stream designed to be sufficient to cover Project debt service, as well as operation and maintenance expenses, during the early years of the Agreement by fixing the Project revenues at a rate higher than current actual avoided cost, since the capacity is not estimated to be needed until 1995. However, over the thirty-year life of the Project, the present value of the capacity payments to Mon Valley is slightly lower than West Penn's estimate of the present value of the capacity assumed to be delayed or avoided.

The EEPA is subject to certain conditions precedent, including securing a final order from the Commission, satisfactory to WPP, allowing WPP a full and timely pass through to its ratepayers, via its ECR, of all charges payable by WPP under the EEPA.

West Penn intends to treat purchases from the Project as interchange purchases allocable solely to Pennsylvania.

PHASE I PROCEEDINGS

III. DISCUSSION

A. *The Legal Standard to be Applied*

Although the Commission has specific regulations governing the calculation of avoided costs, the rates set forth in the EEPAs in question were calculated under WPP's methodology. The parties differ about how to determine if the EEPA rates are at or below WPP's avoided costs.[7] Before discussing the parties' positions it is necessary to review briefly the legislation pertaining to non-utility generation.

PURPA became law in 1978. It is an attempt by Congress to increase the use of renewable energy resources and, in so doing, further this country's efforts to become energy independent. In PURPA, cogeneration facilities are characterized by the sequential production, from one fuel source, of electric energy and steam that can be used for industrial or commercial purposes. Small power production facilities are defined as those that produce electric energy by the use of biomass, waste or renewable resources and have a generating capacity of 80 MW or less. To encourage development of these facilities, Congress created a class of qualifying facilities that was to be exempt from the bulk of federal and state regulation.

Section 210 of PURPA, 16 U.S.C. § 824a-3(a), requires electric utilities to purchase power from cogenerators and small power producers (hereafter QF's). PURPA states that the rates for such purchase:

> (1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

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[7] The reasonableness of the energy rates has not been challenged; future references refer to capacity rates. See AAL Main Brief at 3.

> (2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

PURPA adds that:

> No such rule prescribed under subsection (a) of this section shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy.

16 U.S.C. § 824a-(b).

PURPA provides that a QF selling power is exempt from FERC provisions requiring general ratemaking approval for sales between electric utilities if the sales of QF power conform to an "incremental cost" standard. The term "incremental cost of alternative electric energy" is defined as "the cost to the electric utility of the electric energy which, but for the purchase from such [QF], such utility would generate or purchase from another source." 16 U.S.C. § 824a-3(d). This rate standard has been termed by FERC, and generally adopted by the industry, as "avoided costs." 18 C.F.R. § 292.101(b)(6).

PURPA required FERC and State regulatory authorities to adopt rules governing the sale of QF power. As noted in footnote 1, *infra*, FERC and this Commission have done so.

The Commission's Order of September 29, 1988, page 3, defines the issue in this proceeding as follows:

> In our view, the fundamental factual issue to be resolved is whether the proposed rates are at or below WPP's full avoided costs as defined by our regulations at 52 Pa. Code § 57.31, *et seq*. If the rates are at or below the rates to which the developers would be entitled as a matter of law, the rates are *per se* reasonable and automatically recoverable from rate payers.

WPP maintains that the purchase rates in the EEPAs are below its avoided costs under either its methodology or

the Commission's regulations. For that reason, WPP concludes that the issue of what standard to apply is not critical. WPP Main Brief (M.B.) at 6-7.

The Projects insist that the formula in the Commission's regulations is the only legally recognized method of calculating WPP's avoided capacity costs. BM&S M.B. at 41-44. The Projects conclude that the reasonableness of the avoided capacity rate in the EEPAs must be measured against the avoided capacity rate calculated under the Commission's regulations.

AAL [8] insists that privately negotiated contracts are outside the scope of the federal and state cogeneration regulations, and it would be improper, therefore, to use those regulations as a standard against which to measure the justness and reasonableness of the rates in this proceeding. Instead, AAL argues that the capacity credits [9] negotiated by WPP must be below its true avoided cost and also provide "savings" to ratepayers under Section 527 of the Code. (AAL's Section 527 argument is discussed and rejected in Section III D 6 below.) AAL also argues that capacity payments under the Commission's regulations exceed avoided costs. AAL concludes that a correct determination of WPP's avoided cost is the initial benchmark against which privately negotiated capacity payments must be judged and that the Commission must insure that the negotiated rate is "some increment" below true avoided cost (its Section 527 argument). AAL M.B. at 37-48.

OCA argues that the Commission's regulations are not applicable to the rates established in the EEPAs of this case based upon the language of the regulations and the

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[8] Although AAL and WPPII each consist of more than one entity I refer to them in the singular.

[9] AAL uses the term capacity *credits* because the Commission's regulations use the same term. It is a confusing term, however, and I refer to them as capacity *payments* or *rates*.

Milesburg decision interpreting these regulations. OCA asserts also that because the regulations do not discount the future value of capacity in setting current rates, the regulations produce rates which are in excess of "incremental costs" and must be considered to violate the rate limitations set forth in PURPA. Even if it is determined that the regulations apply, OCA asserts, the regulations would produce a zero capacity rate as the regulations defining a committed unit or a proxy unit were inapplicable given the facts of this case. Finally, OCA argues that if it is determined that the majority of the WPP assumptions concerning the calculation of the capacity rates were valid, the rates under the regulations are still less than the rates provided for in the EEPAs as such rates should have been calculated based upon the selection of a combustion turbine (CT) rather than the WPP coal units. As a result, OCA concludes, the application of the regulations to the EEPA rates in this case does not support a determination as to the rates which should be approved.

In support of their positions, AAL and OCA rely on the same Commission and FERC regulations and on *Milesburg*. The FERC regulation at 18 C.F.R. § 292.301 (b)(1) reads as follows:

> Nothing in this subpart:
>
> (1) limits the authority of any electric utility or any qualifying facility to agree to a rate for any purchase, or terms or conditions relating to any purchase, which differ from the rate or terms or conditions which would otherwise be required by this subpart.

The Commission's regulation at 52 Pa. Code § 57.32(a) provides that:

> Furthermore, as detailed in subsection (c), nothing in this subchapter will affect existing contracts or future contracts freely entered into by utilities and qualifying facilities.

52 Pa. Code § 57.32(c) provides in part that:

> (1) Nothing in this subchapter:
>
> (i) Limits or extends the authority of an electric utility to agree to a price for a purchase or to terms or conditions relating to a purchase which differ from the terms or conditions which would otherwise be required by this subchapter.

In *Milesburg*, the Commonwealth Court discussed the relationship between privately negotiated QF contracts and the federal and state regulations as follows:

> The regulatory scheme adopted by FERC also permits utilities and QFs to negotiate agreements for utility purchase of power independently of the prescribed rates. 18 C.F.R. Section 292.301. Thus, even if a state chooses to implement the FERC regulations by adopting rules of its own prescribing a purchase rate in detail, a utility and a QF may still negotiate a different rate, using the state-prescribed rate as a base line. Because no large utility is exempt from the FERC regulation that requires filing of detailed utility cost data and projections with the State Regulatory Authority, 18 C.F.R. § 292.302, a QF negotiating an agreement with a utility knows what rate it could compel if the utility fails to bargain in good faith. Although privately negotiated contracts setting rates for QF power are essentially outside the federal and state rules, state public utility commissions have a duty to examine costs of such contracts claimed by a utility for the purpose of setting its own rates, and will disallow those found to be excessive. Therefore, the state regulatory authority plays an indirect role in the negotiating process.

Milesburg at 1300. AAL also relies on *Petition of Pagnotti Enterprises, Inc.*, P-870281 where the Commission in its August 18, 1988 Order, granting reconsideration of a previous order, stated as follows:

> Generally, however, negotiated agreements between utilities and QFs take precedence over the terms and conditions that otherwise could be required by our regulations.

Based on the foregoing, AAL concludes that it is a "point of law" that privately negotiated contracts are "essentially outside the federal and state rules" and that, therefore, it is improper to judge the reasonableness of the EEPA capacity payments by comparing them to rates calculated under the state regulations. AAL M.B. at 39. OCA concludes that the Commission and FERC regulations indicate an intention not to "affect" EEPAs voluntarily entered into and that rates calculated under the Commission's regulations provide no basis upon which the EEPA rates may be approved for recovery by WWP. OCA M.B. at 72-73. I disagree.

In *Milesburg*, the Commonwealth Court recognized that a utility and a QF may negotiate a rate different than that prescribed in the Commission's regulations, *"using the state-prescribed rate as a base line." Milesburg* at 1300. (emphasis added) A negotiated contract is "outside" the Commission regulations only to the extent it contains terms and rates other than those prescribed by the regulations. This does not mean the regulations cannot be used as a measuring rod. There is no "point of law" (whatever is meant by that term) that prohibits the Commission from concluding, as it did in its Order of September 29, 1988, cited above, that if the rates are at or below the avoided costs to which the QF would be entitled as a matter of law (i.e., as defined by the Commission regulations), the rates are *per se* reasonable. The formula in the regulations was promulgated by the Commission in response to the PURPA mandate. Until invalidated by the Commonwealth Court [10] or

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[10] WPP has challenged the validity of the Commission regulations computing capacity payments. The proceeding, at Commonwealth Court Docket No. 91 CD 1983, is pending.

changed by the Commission [11], the formula is the state-prescribed method of arriving at avoided costs and must be used by the Commission to judge the reasonableness of avoided costs set forth in agreements negotiated by a utility and a QF.

Anticipating reliance on the "base line" statement in *Milesburg*, AAL refers to it as follows:

> . . . it should be recognized that an *assumption* underlying this statement *must have been* that the state-prescribed rate under the state regulations would result in a capacity credit that was equal to true avoided cost.[5] However, as discussed *infra*, the testimony in this case clearly demonstrates that the capacity credits calculated pursuant to the state regulations invariably result in rates greatly in excess of avoided cost. Comparing a negotiated rate with a rate which is without question greater than true avoided cost is of no value. Thus, *the court must have intended* the parties to compare the negotiated rate with a rate which is an accurate determination of WPP's true avoided cost. (footnote omitted; emphasis added)

AAL M.B. at 40. AAL's reasoning is based on speculation. The issue of whether the Commission's regulations calculate rates in excess of avoided cost was not discussed by the Commonwealth Court in *Milesburg*. AAL is reduced, therefore, to judicial mindreading to support its position. This is most certainly a method inferior to interpreting the plain and clear meaning of the Court's words, namely, that the avoided costs set by the Commission's regulations can be used as a baseline against which to measure the rates set in the EEPAs in question.

OCA and AAL argue that the capacity payments calculated under the Commission's regulations cannot be

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[11] The Commission's proceeding at I-860025 is re-examining the cogeneration regulations and could result in changes in the formula.

used as a baseline because they exceed avoided costs. OCA M.B. at 73-80; AAL M.B. at 40-44. While they might be correct, this is not the correct proceeding within which to determine the accuracy of the Commission's calculation of avoided costs. As noted in footnotes 10 and 11 above, two other proceedings address this issue and it would be improper to rule on the accuracy of the regulations here. As noted, until invalidated by Commonwealth Court or changed by the Commission, the regulations are valid as they are.

Even though the regulations cannot be challenged here, and even though they can be used as a baseline, the evidence in this record does not support the use of calculations under the regulations *in these proceedings.*

Only WPP calculated avoided costs under the Commission's regulations. (The Commission Staff calculation (ALJ Ex. 1) was submitted without a sponsoring witness and carries no weight because it is hearsay evidence.) WPP's calculation, however, cannot be accorded much evidentiary value.

WPP witness Kave made the calculation even though he does not believe the calculation to be appropriate for the determination of WPP's avoided costs. WPP St. 1-S at 1. Mr. Kave noted that WPP has appealed these regulations on the basis that they overstate avoided costs. WPP St. 1-S at 2. When asked why he characterized his calculations of the rates under the Pennsylvania Regulations as estimates, Mr. Kave responded that:

> The actual calculation which would have to be performed for a more precise determination would depend upon a number of unknown factors. For example, the capacity rate calculation for a project would be performed at the time of acceptance by the qualifying facility (QF) [§ 57.34(c)(1)]. This could impact the determination of CB, the booked construction costs. I have no way of precisely know-

> ing on what date the QF would have accepted a calculation under the Pennsylvania Regulations.
>
> * * * *
>
> In addition, after initial rates have been established, certain adjustments occur to the capacity and energy rates . . . No attempt has been made to estimate these adjustments.

WPP St. 1-S at 3-4.

Owing to the nature of the calculation of avoided costs in the Commission's regulations and owing to the slight evidentiary value which can be given to the only calculation sponsored by a witness in this proceeding, the reasonableness of the capacity costs in the EEPAs in question should be measured against WPP's methodology, not the Commission's regulations. *This determination is limited to these proceedings.* It should not be applied to future proceedings where different record evidence is available.

B. *Burden of Proof*

The OCA in its Main Brief argues that WPP must meet a heavy evidentiary burden in this proceeding:

> The Pennsylvania Supreme Court has made it clear that the party with the burden of proof has a formidable task before its position can be adopted by the Commission. Even where a party has established a prima facie case, the litigant still must establish that 'the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, *precluding all reasonable inferences to the contrary*.' *Burleson v. Pa. PUC*, 501 Pa. 433, 437, 461 A.2d 1234, 1236 (1983) (emphasis added).

OCA M.B. at 16.

This proceeding is not a proceeding upon motion of the Commission and, therefore, the burden of proof enunciated in Section 315 of the Code, 66 Pa. C.S. § 315, does not apply. As the proponent of a rule or order, WPP has the burden of proof. Section 332(a) of the Code, 66 Pa. C.S. § 332(a). It is the duty of the party with the burden of proof to produce substantial evidence which, if believed, warrants the decision sought. *Smith v. Bell Telephone Co. of Pa.*, 397 Pa. 134, 139, 153 A.2d 477, 480 (1959). Substantial evidence is "that quantum of evidence which a reasonable mind might accept as adequate to support a conclusion." *Norfolk and Western Ry. Co. v. Pennsylvania Public Utility Comm'n*, 489 Pa. 109, 128, 413 A.2d 1037, 1047 (1980). No particular type of evidence is required; the only requirement is that the evidence as a whole be legally sufficient to support the order of the Commission. *Motor Freight Express v. Pennsylvania Public Utility Comm'n*, 180 Pa. Super. 622, 627, 121 A.2d 617, 620 (1956).

WPP's burden is not as formidable as OCA states it is. WPP must meet its burden of proof by substantial evidence, however, and the record in these proceedings will be examined in that light.

C. *Time Frame*

As noted, in the above History of the Proceedings, in its January 19, 1989 order, the Commission stated that the parties are free to argue that circumstances unique to these proceedings justify a departure from its policy that the appropriate time for determining avoided costs is the time during which serious negotiations take place.

WPP justifies its calculations of avoided costs as of the time of agreement in principle on rates and argues that AAL has not shown any unique circumstances to justify a departure from the Commission's policy. WPP M.B. at 44-51. The Projects cite the indicia of serious negoti-

ations enunciated by the Commission in *Pa. P.U.C. et al. v. Duquesne Light Company,* R-860556C001 (Order dated July 20, 1987) (*Duquesne*), and equate the serious negotiations standard to the period when WPP and the representatives of each Project discussed an agreement in principle on rates, but before WPP internally formulated the price. BM&S M.B. at 29-41. AAL argues that the Commission should use the time of the signing of the contracts in question because to do otherwise would deprive ratepayers of the consequences of two major tax changes which were enacted before the contracts were signed. AAL M.B. at 26-36. OCA uses WPP's agreement in principle dates. OCA St. 1 at 6-7; OCA M.B. at 19.

The negotiation process between a cogeneration project developer and a utility is lengthy and complicated. (See generally BM&S M.B. at 6, 8-10, 12 and the transcript and statement references made there.) WPP witness Kave describes WPP's negotiation process in WPP Statement 1, his direct testimony. He states as follows:

> West Penn is part of an integrated utility system known as the Allegheny Power System. The negotiation of PURPA contracts for West Penn and its sister companies, Monongahela Power Company and The Potomac Edison Company, is conducted on a centralized basis by the Allegheny Power Service Corporation ("APSC"). Since generation planning is done on a system-wide basis, avoided cost rates for eligible qualifying facilities are also determined on a system-wide basis. The paramount concern during such negotiations is that qualifying facilities who desire to avoid capacity must provide firm, reliable capacity at rates no greater than avoided costs.

WPP St. 1 at 4.

After a QF contact, WPP [12] receives information from the QF regarding size, type of project, location and schedule for deliveries. During later meetings to discuss purchase rates, project characteristics and negotiating guidelines, WPP tries to determine what the QF wants from WPP, if the QF can provide firm, reliable capacity, and if an agreement on purchase rates can be reached. If a price is agreed upon (the agreement in principle on rates), a formal Project Price Proposal, if approved by WPP management, is sent to the QF. This Proposal is an offer by WPP to purchase capacity and/or energy from the QF for a specific term and in-service date, subject to an ultimate agreement on all the terms and conditions. The proposal remains valid for a period of 3 months while negotiations are completed on the basic business arrangement, called a term sheet. Upon completion of a term sheet, customized for each project, a contract (the EEPA) is negotiated, drafted, finalized, and filed with the Commission for approval. WPP St. 1 at 4-5.

According to Mr. Kave:

> The crucial point in the negotiation process is the agreement in principle on purchase rates, which are recommended to senior management for inclusion in a formal Project Price Proposal. Prior to the acceptance of purchase rates, APS has very little confidence that the parties will be able to proceed with the transaction and that APS will be able to avoid the construction of capacity. Typically, a QF is unwilling or unable to commit to sell power in any amount or for any specific length of time absent an agreement on rates. On the other hand, once an agreement in principle on rates is reached and a QF is willing to proceed, APS believes, for reasons I will

[12] In the following discussion APS and WPP are used interchangeably owing to the centralized negotiation of WPP's PURPA contracts.

> PURPA developer would commit to provide capacity if the rates were too low. Consequently, if there is no agreement on purchase rates, then there is no sound basis for avoiding capacity.

WPP at 10-11.

For the Milesburg Project an agreement in principle on purchase rates was reached in May 1986; a firm price proposal was sent on May 27, 1986. WPP St. 1 at 21. For the Burgettstown Project the dates are October 1986 and March 3, 1987, respectively. WPP St. 1 at 23. For the Shannopin Project the dates are September 1986 and October 17, 1986, respectively. WPP St. 1 at 24. For the Monongahela Project the dates are April 1985 and April 18, 1985, respectively. WPP St. 1 at 22.

AAL criticizes WPP's negotiation process, pointing out that its length renders the serious negotiations concept nebulous and allows for significant changes to take place which would alter the calculation of the capacity cost. AAL adds that during the negotiations of the EEPAs in question, interest rates fell, other projects negotiated with WPP, and two major tax changes were enacted. AAL then asks the question: "Should the QF developer be allowed to choose the point in time during the two years or so of 'serious negotiations' that generates the highest capacity cost rate?" AAL M.B. at 29. In my opinion, the correct response to this is another question: Should AAL be allowed to choose the point in the negotiation process that generates the lowest capacity cost rate? The answer to both questions is "no". Objective criteria are needed and must be applied consistently to give reliability (with respect to time frame) to utility/QF negotiations.

Next, AAL criticizes WPP for being bound by an oral agreement in principle as opposed to a written contract especially since the interim written documents, the term sheets, state that they are not binding regarding any

> explain later in my testimony, that there is sufficient assurance to assume that capacity costs will be avoided for planning purposes.

WPP St. 1 at 9. He explains why APS requires the QF to agree to a rate before issuing a Project Price Proposal as follows:

> By definition, avoiding capacity means that West Penn would include the QF capacity in the APS Integrated Resource Plan, defer or cancel new construction, and commit to a dependence on the QF capacity for serving its customers. Such a reliance on outside resources cannot be taken lightly. APS has received hundreds of contacts system-wide from new developers and existing cogenerators who have indicated a desire to sell power if acceptable terms could be reached. Less than 10% of these contacts have resulted in commitments to sell power. If all of these contacts, meetings, and negotiations were considered to be commitments to be included in the APS Integrated Resource Plan, West Penn's and APS's future plans would be nonsense.
>
> Experience has shown that there is no commitment to provide capacity until an agreement in principle on purchase rates is reached. Even then, the commitment is somewhat tenuous, and must be relied upon with caution. Consequently, we feel that capacity planning and the concepts of avoided costs require that agreement on purchase rates be the starting point for determining the level of commitment of potential PURPA projects.
>
> To issue a Project Price Proposal during exploratory discussions with the developer, when there is no commitment or agreement in principle on purchase rates, is unjustified. Practically all PURPA developers would commit to provide capacity if the purchase rates were high enough; conversely, no viable

provision including the price to be paid for Project Energy. AAL argues that WPP's ratepayers should not be bound long in advance of a written contract and "in defiance of beneficial changes" occurring before the contract is signed while the QFs are, as a practical matter, not bound at all. AAL M.B. at 31-32.

AAL's argument misses the point. The beneficial changes it refers to (particularly the Tax Reform Act of 1986 (TRA-86), which reduced the corporate federal income tax rate and the reduction of the Pennsylvania Corporate Net Income Tax (CNI) rate on January 1, 1987) could as easily have been detrimental to WPP's ratepayers. In other words, the tax rates could have been increased instead of decreased. If so, AAL, the two members of whom are WPP ratepayers, would probably argue in favor of a time earlier than the enactment of TRA-86 and the reduction of the CNI, a time such as agreement in principle on rates.

The reason for WPP's reliance on the time of agreement in principle on rates is that APS has determined, as a result of experience in negotiations with QFs, that at this time its risk of relying on a project's capacity for planning purposes is significantly reduced. WPP St. 1 at 9, Tr. 83-86, 297. This is important for WPP because it has a duty to serve its customers pursuant to Section 1501 of the Code, 66 Pa. C.S. § 1501.

On page four of its September 30, 1988 order in these proceedings, the Commission gave the reasons for its time frame policy:

> In order to prevent avoided cost rates from evolving into a constantly moving target, and to prevent utilities from depriving qualifying facilities of avoided cost rate entitlement by delaying negotiations, we consistently have evaluated avoided costs by reference to the time period during which serious negotiations take place . . . FERC's preamble to its regula-

> tions states, inter alia, that use of the term "legally enforceable obligation" is intended to prevent a utility from circumventing the requirement that provides capacity credit for an eligible qualifying facility merely by refusing to enter into a contract with the qualifying facility.

See, preamble to 18 C.F.R. §§ 292.304(b)(5) and (d), 45 Fed. Reg. 12224, February 25, 1980. There are other reasons to pick a consistently applied time frame. Most QF's depend upon their revenue stream from the utility to repay loans because most QF projects have very little equity invested. Accordingly, without a firm commitment on price from a utility, financing is difficult to obtain because lenders require evidence of a guaranteed revenue stream before financing the project. Without such a commitment to a revenue stream, contractors and engineers will be reluctant to submit bids on the project and the permitting process could be jeopardized. MEI St. 1 at 1-7; WPP St. 2 at 3-7; Tr. 8-9, 33-34, 393-394, 400-402.

Ultimately, no matter what time is used to fix EEPA purchase rates, the ratepayers bear a risk that avoided costs will go down after that time and the QF bears the risk that avoided costs will go up. As noted, WPP sets the times of agreemnt in principle on rates as May 1986, October 1986, September 1986 and April 1985 for the Milesburg, Burgettstown, Shannopin and Monongahela Projects, respectively. I accept these dates as times when serious negotiations were taking place under the Commisison's definition thereof as set forth in *Duquesne*. Under *Duquesne*, some indicia of serious negotiations are:

> (1) evidence of FERC certification granting qualifying status to the facility; (2) a statement of project definition including preliminary project design; (3) letter of intent or similar evidence of host site control; (4) evidence of adequate fuel supply consistent with anticipated project life and energy produc-

tion; (5) a plan for obtaining all necessary project licensing; and (6) preliminary evidence of financial feasibility of project and a preliminary financing plan.

Duquesne at 5; See also *City of Pittsburgh v. Duquesne Light Company*, C-871584 (Opinion and Order entered October 6, 1988). While the list in *Duquesne* is not all inclusive, evidence of a project making substantial progress toward meeting the indicia can be considered as evidence of serious negotiations.

Based upon this record, for all projects, WPP's time of agreement in principle on rates meets the Commission's definition of serious negotiations. MEI St. 1 at 4-7; MEI Ex. 1; Tr. 88, 90, 101-102, 119; Burgettstown Sts. 5, 5-B and 6-A; WPP St. 1 at 23; Tr. 372, 1253; Shannopin St. 1; BM&S St. 1; Tr. 250-251. AAL has not shown any unique circumstances to justify a departure from the Commission's policy.

D. *The Reasonableness of the Capacity Rates in the EEPAs*

1. *WPP's Methodology*

WPP's methodology for calculating the avoided costs in the EEPAs is set forth in WPP Exhibit 1 and described in WPP Statement 1 at pages 15-20 generally and at pages 20-24 for each Project. WPP's methodology is included in a report captioned "The Value of Generating Capacity". WPP Ex. 1. WPP's methodology calculates avoided costs by determining the amount of overlap between the QF's supply of capacity and the APS need for capacity. This overlap shows how much capacity (in months) can be avoided by recognizing the in-service date and economic life of the APS plant as well as the in-service date and contract term of the QF. These avoided costs are spread over the QF contract term as a levelized rate such that the present value of the avoided

APS plant costs equals the present value of the payments to the QF. According to Mr. Kave, these equivalent present values ensure that the ratepayers pay no more for QF capacity than the avoided costs of the APS plant, regardless of the in-service date and contract term of the QF. WPP St. 1 at 15-16.

The APS need for generating capacity is determined from the APS Integrated Resource Plan which, for these Projects, showed that new, avoidable generating capacity would be needed in the form of three, 300 Mw coal-fired units. These units were included as a part of WPP's annual system cost data filing (52 Pa. Code § 57.33) and the annual resource planning report (52 Pa. Code § 57.49). Mr. Kave states that these units are also consistent with the coal proxy definitions used within the Commission's regulations. WPP St. 1 at 16.

The rates in cents per Kwh will differ among projects depending on the length of the contract term and the QF's in-service date. Generally, the closer a QF's in-service date is to WPP's need for capacity, and the longer the contract term overlaps the life of the avoided plant, the greater the costs are that can be avoided.

Similarly, avoided capacity rates differ depending on when the next APS plant is needed. That is, for a given QF contract term and in-service date, the rate may change if the APS Integrated Resource Plan changes. All other things being equal, the farther into the future the next need for an APS plant, the lower the avoided capacity cost rates will be under APS's methodology. This tends to discourage capacity additions by QFs that are not needed. Conversely, if there is a near term need for capacity, the methodology tends to encourage QF development by offering higher rates. According to Mr. Kave, this sensitivity to forces of supply and demand creates a built-in safeguard against excess capacity problems. WPP St. 1 at 17.

Another reason that capacity rates may differ among projects is that capacity rate calculations are performed using standard APS information and estimates which are available at the time of calculation. Since these calculations are performed at different times, the underlying information may change. WPP St. 1 at 17.

Capacity rates are normally paid to QFs on a cents per Kwh basis for Kwh's of energy which are scheduled and delivered. This provides a strong incentive for the QF to maximize its availability and deliveries. Under dispatch conditions the QF is paid a capacity rate for the amount of capacity which is available and scheduled for possible delivery. Under certain conditions of poor performance, such as excessive deliveries during off-peak hours and inability to meet dispatch criteria, the capacity payments to the QF are reduced. WPP St. 1 at 17.

As noted above, WPP maintains that the EEPA rates are below its avoided costs under either its methodology or the Commission's regulations. No party challenged WPP's methodology or the calculated energy rate in the EEPAs.

At issue are the correctness of the inputs WPP used in its methodology regarding the capacity rate calculation. These inputs include the reserve margin, the type of avoided unit used (coal v. combustion turbine), the avoided unit's availability, and the fixed charge rate.

Also at issue is WPPII's assertion that WPP's capacity rates should be based on the renovated Springdale and Mitchell plants which will come on line before any of the QFs. In addition, OCA argues in favor of a correction to the Milesburg Project avoided capacity costs to reflect monthly payments required by the EEPA. Finally, AAL and WPPII argue for EEPA capacity rates to be passed through to WPP's ratepayers on a demand/energy basis instead of on an energy basis only. These issues are addressed below.

2. *Reserve Margin*

A reserve margin is the percentage by which a utility's firm energy resources exceed peak hour customer demand. OCA St. 1 at 21. WPP is part of the integrated APS system. Generation planning for the system is done on a centralized integrated basis. During 1985 and 1986, and at present, APS has defined its criterion for reserve margin as follows:

> No more than forty to sixty days DSCR (Dependence on Supplemental Capacity Resources) for APS; and a minimum of 25 percent installed reserves at time of winter peak.

WPP Ex. 16 at tab 5 (WPP St. 9 in R-850220, upon Reconsideration, at 16); Tr. 1001.

The APS generation plan dated May 1, 1986 uses a 25% minimum reserve margin criterion and provides for three coal units of 300 Mw each which will come in service in October 1995, 1997, and 1998, respectively. WPP Ex. 8. These are the planned units which were used to compute the avoided capacity rates for the EEPAs in question. WPP St. 1 at 15-16, 20, 22, and 23.

AAL witness Falkenberg would revise the APS reserve margin criterion to 15 percent. AAL St. 3 at 16, 20, 30, and 35. OCA witness Biewald would revise the APS reserve margin criterion to 20 percent. OCA St. 1 at 35.

During its direct case, WPP relied on testimony and exhibits from three previous Commission proceedings which considered an appropriate reserve margin for WPP in conjunction with the Bath County Pumped-Storage Hydroelectricity Facility (Bath County). On November 30, 1984, WPP filed for a rate increase at Docket No. R-842632. *Pennsylvania Public Utility Commission v. West Penn Power,* 59 Pa PUC 552, 69 PUR 4th 470 (August 28, 1985). In large part, the proposed increase reflected the purchased power costs of Bath County.

WPP has included in its Ex. 16 in this case the testimony at Docket No. R-842632 of J. W. Geiser, Vice President of Planning for APS; and Homer T. McCarthy, Director, Generation Planning (now retired). WPP Ex. 16 at tabs 1, 2 and 3. Mr. Geiser's testimony contains a general description of the reserve margin criterion of APS. WPP Ex. 16 at tab 2 (WPP St. 11 in R-842632 at 11-12). Mr. McCarthy's testimony came in rebuttal during which he refuted the testimony of three experts: Messrs. Gerasimou, Falkenberg, and Baron. Among the arguments that Mr. McCarthy refuted was the claim of Mr. Gerasimou that because of APS' many transmission lines interconnecting with other utilities, it had ready access to capacity or energy during times of emergencies. WPP Ex. 16 at tab 3 (WPP St. 15 in R-842632 at 9-11).

The Commission did not approve recovery of the Bath County costs at R-842632 because the plant did not come on line during the future test year. On October 18, 1985, at Docket No. R-850220, WPP filed its second rate case generally relating to the recovery of the cost of purchased power from Bath County. *Pennsylvania Public Utility Commission v. West Penn Power*, 61 Pa PUC 711, 77 PUR 4th 220 (July 24, 1986). In the proceeding at Docket No. R-850220, the ALJ refused to reconsider the question of reserve margin criterion, and struck the testimony, *inter alia*, of Messrs. Falkenberg and Baron. This decision was affirmed by the Commission. 61 Pa PUC at 727-731, 77 PUR 4th at 236-239.

The Commission granted a petition to reopen the record and a petition for reconsideration to consider the effect of Section 1323 (signed into law on July 10, 1986) which deals with excess capacity. This resulted in another hearing (R-850220 Reconsideration) on the subject of the APS reserve margin criterion. WPP has included in its Ex. 16 testimony by Homer T. McCarthy; J. Robert Kissner, Manager, Load Forecasts; Albert F.

Kave, Jr.; J. F. Hose, Manager, Load Modification Program Planning; Kenneth J. Blasko, Manager, System Operations Engineering; and James E. Susman, Vice President of Energy Management Associates, Inc. WPP Ex. 16 at tabs 6-10.

As WPP notes (WPP M.B. at 15-16), the hearings at Docket Nos. R-842632, R-850220, and R-850220 Reconsideration covered the same period (1985 and 1986) relevant to these proceedings. As a result, the question of the APS reserve margin has been the subject of three sets of hearings and two pertinent commission orders. WPP emphasizes the direct testimony of Homer McCarthy offered in September 1987 at Docket No. R-850220 Reconsideration. WPP Ex. 16 at tab 5 (WPP St. 9 in R-850220 Reconsideration). The first 21 pages of his testimony together with supporting exhibits contain a summary of the history of the development of the APS reserve margin criterion; the reasons for its adoption; its continued use by APS; and the use of the reserve margin in APS generation planning.

OCA criticizes this Bath County testimony as not concerning the planning reserve margin required *after* Bath County became a generating resource to APS. OCA M.B. at 20. OCA witness Biewald concludes that the WPP planning reserve margin should be no more than 20%. OCA St. 1 at 18-48.

Using WPP's dates for agreement in principle on rates, Mr. Biewald's analysis was done from the perspective of 1986 using the same method APS used in 1983 when APS last did a reliability analysis of its system. Mr. Biewald checked his analysis by referring to reliability goals set by the East Central Area Reliability Coordination Agreement (ECAR), of which WPP is a member, and other reliability councils. He used current generating unit unavailability data as of 1986, whereas WPP's last use of the program in 1983 used average unavailability data for the years 1976 through 1982. OCA St. 1 at

38-39. Using the updated unavailability data produces an average unit unavailability of 23.8% (as opposed to WPP's 27.4%). Applying this to the APS 1983 capacity reserve margin study produces a reserve margin of 16% to 20%. OCA St. 1 at 40-41; OCA St. 1 at Sch. BB-7.

The use of OCA's 20% reserve margin rather than WPP's 25% planning reserve margin delays the date when additional generating capacity is required to be brought on line by APS. An additional generating unit for APS would not be required in 1995, as projected by APS in 1986, but rather in 1998. The resulting capacity rate reduction from this change for Milesburg [13] would be from 3.12¢/Kwh to 2.45¢/Kwh, for Burgettstown from 3.73¢/Kwh to 2.98¢/Kwh and for Shannopin from 4.08¢/Kwh to 3.24¢/Kwh. OCA St. 1 at 48-49; OCA St. 1 at Sch. BB-11.

AAL attacks the studies supporting the APS reserve margin as outdated. AAL M.B. at 61-66. These studies are the 1981 General Electric over/under societal cost study, the 1984 EMA societal cost study, and the 1983 Capacity Margin Program probabilistic reserve margin analysis. Tr. 1001. OCA's attack on the EMA study appears at OCA M.B. at 38-39.

AAL witness Falkenberg concludes that in the 1986-87 time period APS could have achieved its reliability criteria of 40-60 DSCR with a 15% reserve margin. AAL St. 3 at 26; AAL Ex. 70. He performed a reliability analysis and compared it to the 1987 APS PROMOD III study. AAL St. 3; AAL Ex. 69. After determining that his model was similar to the APS model, he determined the DSCR levels resulting at various APS reserve margins. AAL St. 3 at 26, AAL Ex. 70; Tr. 1288. He then reaches the above conclusion: 40-60 DSCR at reserves of 15%. Mr. Falkenberg also updated the 1981 and

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[13] The initial rate for Milesburg represents a corrected calculation to represent monthly EEPA payments. See Section I D 7 below.

1983 APS Capacity Margin Programs to account for improved generating unit availability, resulting in a 25% unavailability figure which translates to a reserve margin of 17% to 22% at 40-60 DSCR. AAL St. 3 at 33.

AAL supports Mr. Falkenberg's recommendation by arguing that it is consistent with planning reserve margins used by other utilities. *See* AAL M.B. at 70-72. AAL also asserts that a periodic updating of the APS planning reserve margin criteria is essential. In support, it points to a 1983 Commission mandated management audit of WPP recommending two year updates and criticizes APS for not updating its study before committing ratepayers to about $548,000,000 in additional capital expenditures resulting in a $52,557,121 annual rate increase (for all projects except Monongahela). AAL M.B. 72-77.

The Projects presented two witnesses who testified in favor of WPP's reserve margin requirement. In general, the Projects maintain that WPP's methodology conforms to standard industry practices widely accepted by regulatory commissions, that WPP's load forecasting technics result in competent forecasts, and that WPP needs a 25% planning reserve margin because it has an unusually large number of supercritical generating units and because WPP has a higher load factor than most other electric utilities. BM&S M.B. at 46-48.

In his rebuttal testimony WPP witness McCarthy reiterated the factors he considered when recommending to senior APS management the reserve criterion he used. He took into account the following factors:

1. The size of the system and size of the units within the system, particularly the fact that APS had ten super-critical units which ranged from 540Mw to 640Mw, each of which is about 10% of the APS system peak load. Tr. 859.

2. APS' high load factor. APS normally has one of the 10 highest load factors of the top 100 investor-owned utilities in the country. Tr. 860-861.

3. The availability of the units, including the improvement in availability in recent years. Mr. McCarthy rebutted the great significance placed on this improvement by Messrs. Falkenberg and Biewald by expressing concern that this level of availability may not continue for the following reasons: (a) the improvement may be in part due to temporarily higher operating reserves that allow lower levels of stress on individual units, (b) the equipment is aging, (c) extreme weather can result in availability problems, and (d) environmental factors such as possible acid rain legislation could significantly decrease availability. Tr. 861-65.

4. The continued doubt as to the actual availability of the PURPA projects over the terms of their contracts. Tr. 867.

5. The availability of power from other companies in the ECAR region. Although recognizing that APS had fairly high interconnection capabilities, Mr. McCarthy does not rely heavily on this factor because extreme weather conditions normally extend over a large portion of the region so all utilities in the region tend to be in need of power at the same time. Tr. 871-72.

6. The APS difficulty in maintaining adequate power supply during a period of very severe weather. As an example, Mr. McCarthy cited the winter peak of January 21, 1985, when power was not available from other companies in the ECAR region. Tr. 873.

In addition to these factors, Mr. McCarthy relies on experience and judgment to determine an appropriate reserve margin. He testified about this as follows:

> Q. Now, in reaching your judgment as to the appropriate level of reserves, are you—is the means by which you reached this judgment the computation of this 40 to 60 days per year dependence on supplemental capacity resources? In other words, my question, do you use a formula of some kind to reach this judgment, a final judgment of 25 percent?
>
> A. Do I use a formula?
>
> Q. A formula.
>
> A. No. Not necessarily a formula, no.
>
> Q. Would it be fair to say that you use a range of factors that you take into consideration?
>
> A. Yes. I think I—you know, I've been pointing out that many things go into the determination of what would be the appropriate reserve margin. Certainly, these—these studies, such as a capacity margin analysis, studies like what is termed over, undercapacity which indicates what the lowest cost to the customer would be at a certain reserve margin, these are tools that are used. But in addition to those, I apply experience and judgment from my years working with the company.

Tr. 880-81. *See also* testimony of David Nevius, Tr. 1214-1215.

Mr. McCarthy offered the following in response to being criticized for not performing a new formal study on the reserve margin criterion in 1986.

> While we had no formal study, we are continuously looking at all of the factors that would go into the determinations of a reserve margin, which we talked about today, all of these various factors, and what the situation would be, the uncertainties of the future, the uncertainties of forecasts, the weather sensi-

> tivity, what availabilities may be in the future, and what may occur with acid rain, and a host of other things and it was our judgment that 25—minimum 25 percent reserve margin was appropriate.

Tr. 877-878. Also, Mr. McCarthy testified that he and the other eight persons in the generation planning group devoted a significant part of their time in 1986 to the reserve margin criterion question. Tr. 878-79.

WPP successfully rebutted OCA's and AAL's argument that Mr. McCarthy's recommended planning reserve margin is out of line with other utilities and with the recommendations of the North American Electric Reliability Council (NERC) and its various regional councils, particularly ECAR. WPP Exhibit 17 and the testimony at transcript pages 720-727 show that a 25% reserve margin is not out of line with the industry throughout the United States and in ECAR. See WPP M.B. at 22-23. Also, I accept the testimony of David R. Nevius, Vice President of NERC, that there is no national norm of a 15% to 20% reserve margin criterion, as advanced by Mr. Falkenberg, and that there is not a usual assumption that a large, interconnected system has a reserve margin of 15% to 20%, as advanced by Mr. Biewald. Tr. 1211-12, 1215-16. Mr. McCarthy testified that other large, well-interconnected power systems have planning reserve margins of at least 25%. Penn Power (part of Ohio Edison) has a planning reserve margin of 25%, Philadelphia Electric at least 25%, and both Metropolitan Edison and Pennsylvania Electric (part of General Public Utilities) have planning reserve margins of 26%. Tr. 888. It is also Mr. McCarthy's understanding that the PJM pool is going to increase its reserve margin obligations from 22% to 25%. Tr. 889.

WPP Exhibit 17, the testimony of Nevius, and WPP Exhibit 19, the testimony regarding the reserve margins of other Pennsylvania utilities, demonstrate that the re-

serve margin criterion of WPP is not out of line with the industry.

WPP attacks Mr. Falkenberg's model, which changed between 1987 (when he focused on Loss of Load Probability (LOLP)) and 1989 (where he uses DSCR), because he did not disclose the nature of the changes. WPP also notes that Mr. Falkenberg did not submit data about his two models to parties requesting it. Tr. 1312-15. In addition, the model has not been used by any electric utility. AAL St. 1 at 4; AAL Ex. 63. For these reasons, and because it uses a time frame which I reject, *see* Section III C above, I give no weight to Mr. Falkenberg's 1989 model results.

OCA and AAL attack the factors considered by Mr. McCarthy at Tr. 861-65, referenced above. They are discussed below.

a. *High Load Factors and Super-Critical Generating Units*

OCA argues that if a properly determined probabilistic model is used to calculate an appropriate reserve margin, it is unnecessary to change the result to account for load and resource values already embedded in the model. OCA M.B. at 33-37. AAL witness Falkenberg, testifying in support of his probabilistic reserve margin, stated that any such program would take these factors (high load factor, super-critical units) into account. Tr. 1309-10.

Mr. McCarthy, Mr. Schultz and Mr. Depenbrock testified that the high load factors on the APS system support the proposed 25% reserve margin. Tr. 860; MEI St. 2 at 11; B&S St. 1 at 8-9.

Mr. McCarthy and Mr. Schultz also testified that the existence of super-critical coal generating stations on the APS system supports the APS proposed reserve margin of 25%. Tr. 860, MEI St. 2 at 10-11.

OCA has not demonstrated its argument with evidence and I have rejected Mr. Falkenberg's study for reasons given above. WPP has demonstrated that its high-load factors and super-critical generating units support its 25% reserve margin.

b. *Generating Unit Availability*

OCA asserts that Mr. McCarthy used the worst seven years of unit availability data for the 17 year period before 1986. It adds that using availability data for the entire period 1970 through 1986 produces a planning reserve margin of about 18% to 23%. Tr. 974-75. According to OCA, WPP has not supported its outdated use of relatively high unit unavailability rates given the range of rates experienced on the APS system during any period considered reasonable. OCA adds that much of the availability data WPP used predates Bath County, the inclusion of which in 1985 was expected to increase system reliability. AAL argues that the APS use of outdated unavailability data renders the 1983 capacity Margin Program an inappropriate tool upon which to base the calculation of capacity rates. AAL M.B. at 66.

I am satisfied, however, that Mr. McCarthy gave due consideration to the recent improvement in unit availability. In my opinion, in the use of his experience and judgment, Mr. McCarthy did not overstate WPP's reserve requirements for the reasons given during his cross-examination by OCA at Tr. 861-865. He believed that unit availability could decline as capacity margins decline and generating units are fired harder. Tr. 862-63. Lower reserves may result in less maintenance. Tr. 863. APS generating units were aging. Tr. 863. Acid rain legislation could be enacted. Tr. 865. All of these can reduce unit availability and Mr. McCarthy used correct judgment in 1986 that the planning reserve margin should not be changed in response to a then recent improvement in generation availability.

c. *Acid Rain Legislation*

Besides Mr. McCarthy (Tr. 865, 991), MEI witness Schultz (Tr. 507, 1135) posited that pending acid rain legislation may require that additional generation units be built or that existing units be retired. OCA calls this reliance highly speculative and, noting that WPP would not apply the then impending TRA-86, argues that WPP should not be permitted to freely speculate on potential legislation as it chooses. OCA M.B. at 28-29.

There is a difference between TRA-86 and acid rain legislation as they pertain to these proceedings. WPP was correct in not incorporating TRA-86 because it was not enacted during the time of serious negotiations. This time frame is an objective guideline to give consistency to utility/QF negotiations as discussed fully in Section III C above. Whether or not to give weight to pending acid rain legislation in evaluating unit availability, however, is a subjective determination requiring judgment. It is no secret that the utility industry is concerned about acid rain legislation. Although such legislation might allow older generation units to remain in operation (Tr. 992), it could also have the opposite effect. Regardless of this, WPP used correct judgment in considering acid rain legislation as one of several reasons why current availability data might not hold in the future.

d. *Recommendation*

In ruling on the reserve margin question at R-842632 the Commission stated:

> In sum, Mr. Falkenberg recommended a reserve margin of 20%, and Mr. Gerasimou recommended a range of 16% to 19%. However, there is no magic number which applies to all utilities at all times. For example, in refusing to make an excess capacity adjustment for Pennsylvania Power Company, which had a reserve of 32.6%, we recently stated:

"The OCA has presented testimony and extensive argument in support of its recommended 20% reserve generating capacity which it characterizes as being an acceptable standard or benchmark in the electric generating industry. This commission, as early as 1972, urged a reserve capacity of at least 20% in *Pennsylvania Pub. Utility Commission v. Duquesne Light Co.*, 46 Pa. PUC 427, 437, 438, 97 PUR 3d 227, 232 (1972), in order '[T]o cover peak loads, scheduled maintenance, and forced outages in order to avoid blackouts, load curtailments, and voltage reductions.' We do not believe, however, that a capacity reserve margin of 20% or any other specific percentage could or should apply as an industry standard. *An acceptable reserve generating capacity margin for any particular electric utility is dependent upon the generation mix, availability of generating units, peak-load requirements, the period during which the peaking capacity is required, rates of forced outages, transmission capabilities, interconnections with other utilities and transfers of energy during emergency. These are some of the operating factors which must be considered when reaching a determination concerning an acceptable generating reserve margin.*" *(Pennsylvania Pub. Utility Commission v. Pennsylvania Power Co.*, 58 Pa PUC 305, 314, 60 PUR 4th 593, 601, 602 (1984).

The company in this case has presented substantial evidence that, under its particular circumstances, a reserve margin as high as 31% is appropriate, and we accept that judgment. (emphasis added)

59 Pa PUC at 573, 69 PUR 4th at 488. Although the Commission did not approve recovery of Bath County at R-842632, the above discussion is relevant here.

Forecasting a reserve margin requires the use of studies and computer analyses, but the final decision requires

informed judgment based upon experience. WPP produced witnesses and exhibits showing that the studies available when the 25% reserve margin decision was made, and the APS informed judgment based on experience related to events occurring between the time of the studies and the time of the decision, support the APS planning reserve margin which was used to set the avoided costs in these proceedings. I recommend that the Commission accept the APS studies and judgment and approve of the 25% planning reserve margin.

3. *Coal Unit v. Combustion Turbine*

In 1986, WPP projected that the next generating unit which it would construct would be a series of three 300 Mw coal units, the first of which would be brought on line in 1995. These projected avoided units served as the basis for setting the capacity rates for the Milesburg, Burgettstown and Shannopin projects. WPP St. 1 at 22-24. OCA witness Biewald determined that APS erred in planning to build three coal units as its next capacity resource. OCA St. 1 at 50-67. The OCA argues that in 1986 the APS system should have planned to construct oil or gas fired combustion turbines (CTs) to provide peaking capacity before constructing additional coal units. OCA St. 1 at 50.

In its generating mix a utility utilizes both base load plants, which generally offer high capital costs but lower fuel costs, and peaking plants, which offer lower capital costs but higher fuel costs. A mix of these resources economically meets the load of a utility system. A base load plant economically serves constant load which requires their use at a fairly constant level or at a high capacity factor. However, a base load plant cannot economically serve fluctuating peak load. A peaking plant, such as a CT, which will operate intermittently as peak load rises or falls, can most economically serve load which requires operation at a fairly low capacity factor. Thus,

while a peaking unit could not economically serve customer load at a high capacity factor, its operation is far more economic than that of a base load unit when serving incremental peak load. OCA St. 1 at 51; Sch. BB-4 at 4.

Mr. Biewald analyzed the APS system and concludes that it has been and was projected to be overly dependent upon base load capacity. From a fuel diversity perspective APS was also heavily dependent upon coal fired generation. Additional peaking generating resources fueled by oil or gas would have represented a preferable mix of fuel sources and would have increased fuel diversity on the APS system. Mr. Biewald recommends, therefore, that a CT unit, not a coal unit, should be used as the unit to be avoided by the QF capacity under consideration here. He adds that the net effect of adding a 300 Mw coal unit in 1995 would be to increase system operating costs. OCA St. 1.

OCA also criticizes the APS 1986 plans for a baseload coal unit because no formal study was done in 1986. OCA St. 1 at 54-56. Mr. Biewald contends that if such a study had been done, it would have shown a need on the APS system for more peaking capacity before any additional baseload because fuel oil prices had decreased. OCA St. 1 at 57.

OCA also attacks two studies completed by Mr. Geiser in 1984. They are studies upon which, according to Mr. McCarthy, APS relied to support the selection of a base load plant over a CT. OCA M.B. at 47-52. OCA claims that it is incorrect to use the dependent forced outages assumption in the second Geiser study (use of average forced outage rates in the first Geiser study produced results favorable to a CT). The dependent forced outage rate is designed to reflect the dependence of outage rates related to cold weather. Tr. 1701-02. Mr. McCarthy used the three highest monthly forced outage rates throughout the year, regardless of when they occurred, and assigned

these rates to the winter period in the APS production cost model. Tr. 1701. Thus, the dependent forced outage rates assigned to the period of the APS' winter peak were 2.33 times the average of the non-winter outage rates during the 1982-1986 period. Tr. 1697-1700. The actual winter outage rates were 11.5% for this period and 9.6% for the non-winter period. Tr. 1706-07. This reflects a much smaller outage difference than that used in the APS dependent forced outage rates. OCA argues that APS has misapplied the three highest monthly outage rates experienced on its system to the winter months as these high outage rates often occurred in non-winter months. Tr. 1702-03.

The OCA submits that APS could have but did not conduct a study to determine representative outage rates during the winter and non-winter months and then apply these rates in its production cast studies to the winter and non-winter periods. According to OCA, the results of the second Geiser study, and any other APS studies using dependent forced outage rates, cannot be relied upon to accurately project system cost results.

OCA also maintains that had APS done an accurate study in 1984 it would have had to be updated in 1986 to consider the change in oil prices occurring between 1984 and 1986. Doing so would have resulted in CTs being the preferable generating resource. OCA St. 1 at 57.

In response to OCA, WPP relies on Mr. McCarthy's testimony at Tr. 881-86 and 922-24. In developing the 1986 generation plan, Mr. McCarthy evaluated the possibility of adding combustion turbine capacity. Tr. 881-886. He considered the analysis done in 1984 which had indicated that the cost of combustion turbines was higher than the 300 Mw coal units. McCarthy explained that in the fall of 1985, when the 1986 generation plan was being developed, oil prices were just starting to decline, and APS had no assurance about what these prices would

be in the future. Tr. 882-84, 922. McCarthy also considered the availability of economical supplies of coal (Tr. 923) and the national and state policies of encouraging the use of coal, the Power Plant and Industrial Fuel Use Act of 1978 (Fuel Use Act). Tr. 881-82. Finally, McCarthy explained that APS' high load factor, approaching 90% daily, requires more baseload capacity because the equipment has to be loaded over long peaks. Tr. 923.

OCA counters that the Fuel Use Act provides for exemptions for peakload powerplants and that WPP acknowledges that CTs would be used as peakload plants. OCA M.B. at 52-56; Tr. 56, 946. Even so, Mr. McCarthy did not investigate constructing a CT under the Fuel Use Act exemption. Tr. 942-43. Also, other ECAR companies intended to bring CTs on line in 1992-1996. Tr. 854, 986; WPP Ex. 17.

OCA also disagrees with Mr. McCarthy's testimony about oil and gas prices. OCA submits that oil prices began to decline dramatically in 1985, and dropped quite low in 1986, but that Mr. McCarhty made no attempt to change the APS plans to build a coal unit. OCA St. 1 at Sch. BB-12. Also, Mr. McCarthy did not investigate the possibility of purchasing natural gas from producers or pipelines and transporting that gas to an APS generating facility for use in a CT. Tr. 987-88.

OCA argues against Mr. McCarthy's use of WPP's high load factor as a reason not to select a CT. It relies on testimony that APS CTs operate at low load factors. Tr. 938-39.

The Projects witness Mr. Ross criticized Mr. Biewald's method of calculation because:

> In order to properly evaluate the total cost of the resources, you must look at the life cycle. Otherwise, you will always choose a low capital cost, high operating cost resources, which may, and usually is, not the least cost resource.

Tr. 1183. The Projects maintain that by assuming that the oil-fired unit would be deferred for seven years, Mr. Biewald eliminated the need to compare operating costs for the entire 33 year life of the unit. This makes Mr. Biewald's method of comparing coal fired units to combustion turbine units weighted in favor of the unit with the lowest construction cost and the highest operating cost.

The Projects conclude that Mr. Biewald chose a methodology and assumptions that were calculated to give him the result he sought. He should have chosen a methodology and a set of assumptions which would provide a non-biased planner an opportunity to review the options on the basis of the costs over the entire period in which the avoided unit was to be used instead of just an arbitrary and hypothetical period between the installation dates of the two hypothetical units. Tr. 1193-1197; BM&S M.B. at 55-56.

OCA responds by pointing out that Mr. Ross did not submit a life cycle analysis and only supposes that the results would contravene Mr. Biewald's conclusions. As parties supporting the position of WPP, OCA argues that the Projects have the burden of proof and that this requires them to produce an analysis to refute Mr. Biewald's testimony. OCA concludes that the Projects failed to meet the burden of proof by failing to submit comparative cost analysis.

It should be noted that the OCA calculated its capacity cost using CTs by deferring the three 300 Mw coal units, the first of which was scheduled by APS to go on line in 1995, with 832 Mw of CTs. The use of 832 Mw of CTs was based upon WPP's own *1988* Resource Plan as filed with the PUC. OCA St. 1 at 56, 59. This usage of CTs was employed by Mr. Biewald as it represents the results of the first APS study done since 1984 in order to determine what its next generating resource should be. The use of 832 Mw of capacity

is derived from the WPP *1988* Resource Plan which recognized that under the best available projection of oil prices more than 832 Mw of peaking capacity was justified on the APS system. Tr. 836. The APS 1988 recommended addition of 832 Mw of CT capacity was based upon a high forecast of oil prices. Tr. 836.

Using a 25% reserve margin and 832 Mw of CTs results in deferring the first of the three coal plants from 1995 to 2002. Using a 20% reserve margin and 832 Mw of CTs results in deferring the first of the three coal plants from 1988 to 2006. OCA St. 1 at 60. In calculating the present value of future capacity on the APS system, Mr. Biewald reflected the lower capital costs of the CTs, being the first avoided generating units, and also the cost of the later avoided coal units as discounted to present value. OCA St. 1 at 60. While he defers the APS avoided coal unit from 1995 to a later date, he reflects the discounted cost of the avoided coal unit when it later reappears in the OCA generation forecast. In addition, Mr. Biewald has recognized the energy cost benefits associated with the QFs here at issue.

In Mr. Biewald's 25% reserve margin case, the recommended capacity rates based upon the use of CTs before bringing on line base load capacity changes from 3.12¢/Kwh to 2.02¢/Kwh for Milesburg, 3.60¢/Kwh to 2.50¢/Kwh for Burgettstown and 4.00¢/Kwh to 2.69¢/Kwh for Shannopin. In the 20% reserve margin case the recommended capacity rates based upon the same generating unit assumptions are 1.68¢/Kwh for Milesburg, 2.13¢/Kwh for Burgettstown and 2.28¢/Kwh for Shannopin. OCA St. 1 at 64.

The Commission's regulations, 52 Pa. Code § 57.34 (c)(4)(iii), define the proxy unit to be used in avoided cost calculations as follows:

> *System Reliability.* If a utility anticipates inadequate system reliability as a result of not being committed to sufficient plant during any period over the

next ten years, then the estimated construction costs of a new coal plant will be used as a proxy.

The criteria for commitment state that "[a] utility is considered to be committed to a plant if any of the following criteria are met: (A) The utility has spent 10% or more of the total estimated cost of construction or implementation; (B) The plant is due on line within 8 years, if a base load plant, or 5 years, if not a base load plant; [or] (C) Contracts have been signed for significant components of the plant." 52 Pa. Code § 57.34(c)(4)(i). WPP argues that at the appropriate time, WPP did anticipate inadequate system reliabiilty (i.e., a lower than adequate planning reserve) in the next ten years. But because at the appropriate time WPP did not plan to construct any non-base load plant which would come on line within five years nor any base load plant on line within eight years, and because WPP had no signed contracts for significant components of a new plant, WPP was not committed to a plant within the meaning of the regulations. WPP concludes that Section 57.34(c)(4)(iii) applies and the proxy plant is to be a new coal plant. *See also* WPP R.B. at 14-16. OCA interprets this Section differently. OCA M.B. at 18-26. A lengthy discussion of this is unnecessary because I conclude that under its methodology, WPP correctly selected a coal unit.

APS made its decision to use a coal-fired unit when the APS Generation Plan, dated May 1, 1986 was being formed. WPP argues that at that time, Mr. McCarthy took into consideration the many years of satisfactory service to APS and its ratepayers of coal-fired units (there is no record evidence of this); the drastic escalation in the price of oil and gas, even though tempered by a drop in such prices in late 1985 and early 1986; the results of studies which at best showed only a minor financial advantage for combustion turbines; the technological limitation on combustion turbines at that time;

and public policies and laws designed to encourage the use of coal. WPP aserts that all of this provided substantial evidence in support of Mr. McCarthy's decision to use a coal-fired unit as the capacity to be added in 1995. WPP R.B. at 13.

Although OCA's criticisms of the APS decision have some merit, they do not invalidate the experience and informed judgment of Mr. McCarthy. I conclude that WPP has submitted substantial evidence to support the APS decision in 1986 that a coal unit would be required in October 1995.

4. *Mitchell and Springdale Units*

WPPII argues that WPP's true avoidable resources is the renovated Springdale and Mitchell generating units, not three 300 Mw coal fired generating units. WPPII M.B. at 13-20. On April 11, 1983, West Penn filed a petition (Docketed at P-830434) with the Commission requesting permission to discontinue operations at the Springdale Power Station and Units 1 & 2 of its Mitchell Power Station. By Order of May 13, 1983, the Commission permitted West Penn to temporarily deactivate and place in cold reserve Springdale and Mitchell. By order of August 19, 1983, Springdale and Mitchell were placed in cold reserve and removed from West Penn's rate base. In the Bath County litigation it was determined that the 361 Mw associated with the Springdale and Mitchell units were not to be considered installed capacity for the purpose of evaluating whether the Bath County pumped storage project was excess capacity. Order dated August 28, 1985 at Docket No. R-842632 at 45-46; WPP Ex. 15, Vol. I, Tab 5 at 20-21.

WPPII turns to the Commission's regulations which defines the plant to which the utility is committed as generating equipment, purchase power agreements, load management programs, or any other programs designed to meet the capacity needs of a utility. 52 Pa. Code

§ 57.34(c)(3). Next, WPPII notes that neither the Commission's regulations nor the FERC PURPA regulations require that the calculation of avoided cost or the EEPA capacity rates be based upon the costs associated with the construction of *new* generating capacity. WPPII asserts that although the Springdale and Mitchell units are existing units in the physical sense they are not available to serve customer demand and APS and West Penn must expend over $71 million to return the units to active service. Tr. 310, 314; WPPII Exs. 1-7.

Applying the criteria in 52 Pa. Code § 57.34(c)(4) (set forth in Section III D 3 above), WPPII argues that as of 1986 neither APS nor WPP was committed to the three 300 Mw units for the following reasons:

> As of 1986 APS and WPP had not spent 10% or more of the total $2.5 billion estimated cost of construction of the three 300 Mw hypothetical coal units. Tr. 43.
>
> APS and WPP have spent only $11 million toward the construction of these units. Tr. 42.
>
> In 1986 APS and WPP planned to construct and bring the three 300 Mw units in 1995, 1997 and 1998 respectively. Tr. 48.
>
> The first of the three 300 Mw coal plants was due on line in 1995 or within nine years; rather than eight year on-line criteria set forth in the Commission's regulations. Tr. 48.
>
> Neither WPP nor APS have let any contracts for the significant components of the plant. Neither WPP nor APS have let contracts for building the units or buying the generation equipment. APS and WPP have only retained UE & C to complete design work and prepare cost estimates. Tr. 43.

WPPII then applies the above referenced criteria to Springdale and Mitchell. In 1986 the renovation and

reactivation of Springdale and Mitchell was scheduled for 1992 and 1993 respectively. Tr. 313. In 1986, when the rates at issue were calculated, Springdale and Mitchell were due on line within seven years, or well within the eight year period specified by the Commission's regulations. Accordingly, APS and WPP were committed to the Springdale and Mitchell renovation and reactivation rather than to construction of the three 300 Mw units. According to WPPII, its conclusion is supported by the APS and WPP integrated resource plans, not the subjective opinion of an expert witness. WPPII M.B. at 18; WPPII Exs. 1-6.

WP witness Mr. Kave testified that WPP's generation plans indicate that the Springdale and Mitchell reactivation was always delayed until after PURPA projects came into service because the addition of PURPA capacity benefited ratepayers by delaying the costs of reactivation from as early as 1990 and 1991 to 1997 and 1998. Tr. 324. To this, WPPII responds that WPP ratepayers only truly experience the benefit of deferral of the reactivation costs of Springdale and Mitchell if the EEPA capacity rates are properly calculated based upon the $71 million renovation costs, not the $2.5 billion costs of the three 300 Mw coal units.

WPP also argues that WPPII's position is inconsistent with 52 Pa. Code § 57.34(c)(4)(iii), discussed in the previous section. WPP claims that the Generation Capacity Plan in effect at the time of the agreements in principle on rates in 1986 shows that WPP would need additional plant by 1995, *despite* the planned reactivation of the Mitchell units in 1992 and the Springdale units in 1993. WPPII Exs. 4 and 5. WPP concludes that in 1986, WPP was faced with inadequate system reliability within ten years, and it properly used the coal plant as a proxy. WPP Reply Brief (R.B.) at 16-17.

WPP also argues that WPPII's position is inconsistent with 52 Pa. Code § 57.34(c)(4)(i), which provides that

a utility is committed to a plant for avoided cost calculation purposes if it is a baseload plant which is due on line within 8 years or if it is a non-baseload plant which is due on line within 5 years. The Mitchell and Springdale units are oil-fired peaking units, which would only be used when WPP's coal-fired baseload plants are unable to handle the system load. WPP Ex. 16 at Tab 5 (WPP St. 9 in Docket No. R-850220 Reconsideration at 20-21; McCarthy testimony in Docket No. R-850220 Reconsideration, Tr. 1681). Because Springdale and Mitchell are non-baseload plants, and because in 1986 they were not "committed" units under the regulations, they were therefore properly not used as the proxy in WPP's avoided cost calculations. WPP R.B. at 17.

I agree with WPP's application of the facts in these proceedings to 52 Pa. Code § 57.34(c)(4)(i) and (iii). For these reasons, selection of the Mitchell and Springdale units is not mandated here. I do not conclude, as does WPP, that the regulations require the use of costs associated only with a new plant. WPP R.B. at 17-18. Under facts different than those presented here, the Commission might conclude that a plant in cold reserve must be used to calculate avoided costs.

5. *Fixed Charge Rate*

WPP uses a levelized annual fixed charge rate (FCR) to estimate the cost of owning capital assets. It is expressed as an annual percentage, effective for the life of the asset, and applied to the estimated original investment in the asset. In this case, the asset is the estimated original investment in the avoided facilities. The principal elements of the FCR are the cost of capital, depreciation, income taxes, insurance, and property-related taxes.

An FCR enables an engineer or analyst to make a comparison of the present worth of alternative courses of action without going through a detailed, year by year revenue requirement calculation. Tr. 1036. FCRs are

used throughout the APS system in all of the operating companies to do various engineering studies, *e.g.*, to determine the choice of energy supply equipment, and to determine whether to install new equipment or incur additional operation and maintenance expense. Tr. 1037. APS revises FCRs whenever conditions warrant; most revisions occur when the forecast of the future cost of capital is revised. Tr. 1037.

WPP used an FCR of 17.7% for all three Projects. AAL argues in favor of an FCR of 13.88% for the MEI Project and 14.65% for the Burgettstown and Shannopin Projects.

a. *Cost of Capital*

APS used the same cost of capital in the FCR that it uses throughout the APS system for economic studies. Tr. 1320-21. APS did cost of capital analyses for short-term and long-term projections. Tr. 1329. The cost of capital used by APS in the FCR for the avoided cost calculations at issue was a long-term projection. AAL Ex. 78. AAL witness Davila recalculated the cost of capital used by APS in the FCR, using a different capital structure, a different bond rate, a different cost of preferred stock, and a different cost of common stock. AAL St. 1 at 8-12. The major difference between WPP's determination of the cost of capital to be used in the FCR and Mr. Davila's approach is that WPP forecasts cost of capital, while Mr. Davila uses historical data. Tr. 615.

A treatise (by Robert Hahne and Gregory Aliff of Deloitte Haskins & Sells) on accounting for public utilities, which Mr. Davila attached to his prefiled testimony, AAL St. 1 at 7, recognizes the problems inherent in using historical data:

> The idea that historic data express factual conditions has sometimes led to the conclusion that those data are the most reliable data available for estimating

> future conditions. The factual nature of the events as recorded has apparently imbued the data with a degree of soundness and quality that appears to exceed a forecast approach for test year purposes. When conditions are in a state of change, historic data are likely to be the most unreliable in measuring test period conditions as a basis for future rate needs. While projected data using standard forecasting techniques may miss the mark, historic data, with a patchwork of updating, will surely miss the mark. As imprecise as forecasting may be, projected test year data based on reasonable forecasts should consistently come closer to expressing future conditions than will historic data as traditionally used.

Tr. 615-617; AAL St. 1, Appendix A at 3. I agree.

(1) *Capital Structure*

WPP correctly used its targeted future capital structure to determine its long-term projected cost of capital. Tr. 1043. Mr. Davila did not forecast APS' long-term capital structure. Tr. 605-607, 639, 643. In my opinion, it was incorrect for Mr. Davila to use the embedded capital structure from the WPP rate proceeding at R-850220 (Opinion and Order entered in July, 1986).

(2) *Cost of Debt*

APS forecasted future bond rates, whereas Mr. Davila determined bond rates by using an average over the last three months before the hearings in this proceeding. Although Mr. Davila claims that fluctuations tend to average out over the three month period (Tr. 637), WPP has shown that the use of a three month average to forecast future bond rates is unreliable because of the volatility of the bond market over time. WPP M.B. at 33-34; Tr. 607-08; WPP Ex. 22.

Mr. Davila criticizes WPP's bond rate calculation because APS's chief financial officer at the time, John

Adams (now retired), adjusted the seven year Data Resources, Inc. (DRI) bond forecast upward. Tr. 1045-48, 1270-83; AAL Ex. 78.

Between 1985 and 1986, DRI lowered its long-term bond forecasts by about one and a half percentage points. Tr. 1323. Mr. Adams did not adopt the DRI forecast in 1986, and did not drop forecasted bond rates as precipitously as did DRI. In not doing so, Mr. Adams used independent judgment and experience. Tr. 1280-83. Mr. Adams' judgment can be relied upon here owing to his being APS' chief financial officer for over 10 years and owing to his experience in raising capital for the construction of large coal-fired power stations. Tr. 1322. Mr. Davila acknowledged judgment and experience can be used in making long term forecasts. Tr. 1284-85. It turns out that Mr. Adams' experience and judgment were better than DRI's because its 1986 forecast of future bond rates has not been borne out by 1989 experience. Tr. 1284, 1325.

I recommend aceptance of WPP's cost of debt.

(3) *Cost of Preferred Stock*

APS deducted 100 basis points from its 11% cost of debt and arrived at a 10% cost of preferred stock. Tr. 1272-73. Mr. Davila would also use a three month average to determine the cost of preferred stock. AAL St. 1 at 11. His method is rejected, and WPP's method is recommended, for the reasons given in the above discussion on the cost of debt.

(4) *Return on Equity*

APS forecasted its return on equity by adding a risk premium of 400 basis points to the forecasted bond rates. This produced a return on equity of 15%. Tr. 1047-48, 1274-75; AAL Ex. 78 at 4c. The risk premium method is one of several recognized methods for determining the

cost of equity. It is universally recognized that investing in common stock is more risky than investing in bonds. It is assumed, therefore, that to encourage investment in common stock, it is necessary for a company to provide a higher return on common stock than an investor could get in the bond market. Tr. 615.

Mr. Davila supports the use of WPP's opportunity cost of equity determined in its most recent rate case. AAL St. 1 at 9. As WPP points out, this is not a valid forecast of future return on equity because there can be a long time between the rate case ruling and construction of the next generating station. Tr. 1047. WPP also demonstrates that the use of Mr. Davila's methodology in late 1981 results in a cost of debt higher than the return on equity granted in the last WPP rate case (15.8% debt versus 15.25% equity). Tr. 1048-49.

I recommend acceptance of the cost of equity forecast in WPP's FCR.

b. *State and Federal Taxes*

As AAL notes the resolution of this issue depends on the appropriate time frame for the determination of avoided costs. AAL M.B. at 59. AAL adds that even if its time frame is not adopted, WPP's avoided cost calculations are still in error because WPP should have known about and, therefore, used, the change in the federal tax rate in the spring of 1986 (AAL St. 2 at 16) and should have known about the change in the state corporate income tax rate as early as March, 1986. AAL St. 1 at 13. I have not adopted AAL's time frame (the time of signing of the EEPAs) and, therefore, I accept the tax rates used by WPP, namely, those in effect at the time of agreement in principle on rates (which is the same time as the serious negotiations standard of the Commission). *See* discussion at Section III C above. Also, as Mr. Kave pointed out, at the time the agreements in principle were reached, the language of the TRA-86

had not been finalized, hundreds of transition rules were being developed, and even tax experts did not know what the effects of TRA-86 would be. Tr. 115-16. Finally, changes in the tax laws after 1986 could not be predicted, and these changes could result in either increases or decreases in avoided costs. Tr. 306.

APS used the correct level of state and federal taxes in calculating its FCR.

c. *Ad Valorem Rate (Insurance and Property Taxes)*

WPP used a 1.3% ad valorem tax which included .3% for insurance and 1% as an average of property related taxes over the APS system. Tr. 1083. Mr. Davila analized property taxes paid as a percent of gross plant for the APS operating companies over the years 1985-1987. AAL St. 1 at 14; Tr. 621. He weighted the resulting operating company property tax rates to arrive at a system wide property tax rate of .52%. AAL St. 1 at 14. Mr. Davila did not include insurance costs as part of the FCR because insurance is included in the energy rate as part of operation and maintenance expenses. Tr. 651.

Mr. Davila did not, however, consider the effects of the Pennsylvania and Maryland Capital Stock Taxes and the West Virginia Business and Occupation Tax. Tr. 1055-56. Mr. Davila did not know if he took into consideration the Pennsylvania Capital Stock Tax, and also stated that he was not familiar with the Pennsylvania Capital Stock Tax. Tr. 622-23. Also, he did not consider the West Virginia Business and Occupation Tax. Tr. 623-24.

As WPP witness Binder explained, APS' tax liabilities under the Pennsylvania and Maryland Capital Stock Tax laws and the manufacturer's tax portion of the West Virginia Business and Occupation Tax are affected by the construction of a generation plant and are, therefore, properly included in the fixed charge rate. Tr. 1056-58.

AAL attacks WPP's 1.3% ad valorem tax for two reasons. First, .3% should not have been included for insurance because it is included in the energy rate as part of operating and maintenance expenses. Second, WPP has not documented the accuracy of its 1% assumption for the property tax rate.

To rebut the first reason, WPP refers to the EEPAs and to FERC accounts and regulations. WPP R.B. at 25. The EEPAs make clear that WPP's avoided energy costs are calculated based upon costs chargeable to FERC accounts 500 through 507 and 510 through 514. *See* the description of energy purchase prices, AAL Ex. 11, Section 1.2; AAL Ex. 24, Section 1.2; AAL Ex. 40, Section 1.2. *See also* the definitions of "Avoided Energy Cost Rate", "Average Production Cost Rate", "Variable Energy Cost Rate", and "Fixed Energy Cost Rate", AAL Ex. 11, Section 9.1; AAL Ex. 24, Section 9.1; AAL Ex. 40, Section 9.1. According to the FERC's regulations, the 500 through 507 and 510 through 514 accounts cover certain operation and maintenance expenses involved in steam power generation. *See* 18 C.F.R. Part 101 for a description of these FERC accounts. I agree with WPP that Mr. Davila's position on insurance costs is inconsistent with the terms of the EEPAs.

To rebut the second reason, WPP refers to FERC accounts and regulations once again. WPP R.B. at 25-26. The insurance costs included in the ad valorem rate represent property related insurance. Tr. 1081-82. Under the FERC's regulations, 18 C.F.R. Part 101, property insurance costs are chargeable to account 924, and not to one of the 500 series accounts enumerated in the EEPAs:

> 924 Property insurance.
>
> A. This account shall include the cost of insurance or reserve accruals to protect the utility against losses and damages to owned or leased property used

> in its utility operations. It shall include also the cost of labor and related supplies and expenses incurred in property insurance activities.

WPP concludes that because the property-related insurance costs were not included in the calculation of the avoided energy cost rate, and because the property-related insurance is a relevant cost associated with avoided capacity, it was proper for APS to include the property insurance costs in the ad valorem rate when APS was calculating its FCR. I agree.

I recommend acceptance of the ad valorem rate in the APS FCR.

d. *Rate Base*

The calculation of the year by year revenue requirements for determination of an FCR requires the use of a rate base. Tr. 1038-1041; WPP Ex. 21. A year by year revenue requirement is calculated by adding, among other things, the annual book depreciation plus the cost of capital and applying a present worth factor. Tr. 1040; WPP Ex. 21.

WPP used a beginning of the year rate base, but Mr. Davila modified WPP's revenue requirement calculation to reflect an average rate base. AAL St. 1 at 6-7; AAL St. 1, Appendix A at 3. The average rate base model he used, however, does not include discounting to present worth. Tr. 620. The revenue requirement calculations done by Mr. Davila and APS are necessarily discounted to present worth, Tr. 617-18, 1041, and, therefore, require a different model than the average rate base model. Tr. 1041-42. As Mr. Binder demonstrated, Mr. Davila's model has the anomalous result of making the book depreciation plus the cost of capital, discounted to present worth, yield a result lower than the initial investment. Tr. 1040-41; WPP Ex. 21. This conflicts with Mr. Davila's acknowledgement that the book depreciation plus the cost of capital, with appropriate discount factors applied, should equal the initial investment. Tr. 617.

Mr. Davila's method is rejected and WPP's is accepted. Mr. Davila's method is flawed for the above reasons. WPP's method, which is different than the average rate base model, is correct for developing an FCR for cost recovery over an extended period. Tr. 1038-1042; WPP Ex. 21.

e. *Recommendation*

In consideration of the above, I conclude that WPP's FCR is calculated correctly. I recommend its acceptance.

6. *Section 527 of the Code*

AAL argues that, in Pennsylvania, purchases from QFs must be less than avoided costs because Section 527 of the Code, 66 Pa. C.S. § 527, mandates that the purchases must result in savings to the ratepayers. AAL M.B. at 47-48.

Section 527 provides that:

> The commission shall promulgate rules and regulations concerning the rates, terms, conditions and availability of cogeneration in this Commonwealth. The commission shall require that utility rates to the public reflect savings to the utility from cogeneration.

In rejecting AAL's position in its Order on Reconsideration entered January 19, 1989, the Commission stated as follows:

> Suffice it to say that, absent a voluntary agreement otherwise, rates paid to a qualifying facility must be based under federal law on a utility's full avoided costs, and any state requirement that a qualifying facility involuntarily accept a lower rate would be preempted. (emphasis in original)

Mimeo at 6. In response, AAL argues that since in fact there can be no savings to the ratepayers with the use of

the full avoided cost standard, logic dictates that Section 527 was intended to apply where the full avoided cost standard does not apply, i.e. in the case of the voluntarily negotiated contract.

AAL agrees with the conclusion of the Commission that "absent a voluntary agreement otherwise" Section 527 would be preempted by federal PURPA standards. But, if Section 527 is to have any application at all, AAL concludes, it must mean that in cases such as those under consideration where there is a voluntarily negotiated contract, the Commission must find that there are savings which result to the utility's ratepayers. AAL R.B. at 21.

AAL is engaging in legislative mindreading with no support except stretched logic. If Section 527 cannot be applied to the avoided cost calculated under the Commission's regulations it also cannot be applied to a voluntary agreement where, as determined by the Commission, the rates are set at full avoided costs. Besides, the record here demonstrates that the EEPA rates are below WPP's avoided costs so, even though not mandated by Section 527, there already is a savings passed on to the ratepayers.

The second sentence of Section 527 has no application to avoided costs set under the Commission's regulations or under negotiated contracts.

7. *OCA's Correction to the MEI EEPA*

OCA argues that the Milesburg EEPA capacity rate should be reduced from 3.3¢/Kwh to 3.12¢/Kwh to reflect the monthly payments made under the contract. OCA M.B. at 66-70. Mr. Biewald testified that the MEI capacity rate calculation is inconsistent with the calculation used for the Burgettstown and Shannopin projects. For these later two projects, WPP added a Step 8 to calculate the time value of money effect of paying the QFs for their power monthly. The Milesburg rate, how-

ever, was calculated as if the payments were made annually. OCA St. 1 at 9.

OCA argues that to reflect the value of the QF capacity to the WPP ratepayer, which capacity was scheduled to go on line in 1990 under the EEPA but would otherwise not be required by WPP until 1995, the actual monthly payments to Milesburg must be reflected in the discounting formula. Mr. Biewald testified as follows:

> Like the Burgettstown and Shannopin projects, Milesburg will receive energy payments on a monthly basis. For that reason, I have used the same methodology for calculating the Milesburg payments that I used for calculating the Burgettstown and Shannopin payments. My use of the refined methodology shows that the proposed Milesburg rate is above the level that would result from the Company's own current calculation methodology.

OCA St. 1 at 9.

Mr. Kave, a WPP witness, seems to confirm Mr. Biewald's adjustment. He testified as follows:

> Q. Mr. Kave, but would you agree that under the West Penn Power formula, when the Milesburg rates were calculated, West Penn was using an annual payment assumption in determining those rates?
>
> A. The methodology that was in use at that point in time calculated the capacity rates available to any project on the basis of an annual capacity rate.
>
> Q. And when the Burgettstown and Shannopin rates were calculated, West Penn Power had gone to a monthly payment assumption, is that correct?
>
> A. I have a little difficulty with your words payment assumption, but I think that's correct.
>
> Q. Let me try to be very specific. In the West Penn Power method you use a mathematical formula which makes certain assumptions as to the frequency

with which the QFs would be paid for their capacity, is that correct?

A. Generaly that's correct.

Q. And again, for Milesburg it was annual, for Burgettstown and Shannopin it was monthly?

A. That's correct.

Q. In fact, are each of these three projects to be paid on a monthly basis under their contracts?

A. Yes.

Q. And if you were—let me rephrase that. Holding all other assumptions equal, if you were to calculate a rate based on an annual payment or a monthly payment, how would those rates differ?

A. The monthly payment rate would be smaller.

Tr. 69-70.

Although all three projects rates are the result of negotiated contracts, there is no evidence in this record to support using a different method to calculate the MEI rates. The MEI EEPA was first in time. After it was executed, WPP added Step 8 to its calculation in the other EEPAs. Without Step 8, the MEI capacity rate calculation is flawed because under it payments are made monthly but calculated as though made annually. The MEI rate does not accurately reduce the cost of future capacity to present value and does not, therefore, render ratepayers indifferent to paying for WPP's capacity or for a QF's capacity.

WPP's Reply Brief is silent on this issue. MEI points out that WPP's methodology was not amended until after the MEI calculation was finalized. MEI claims that by requesting a hindsight change in WPP's methodology, OCA is engaging in a selective modification of the methodology. BM&S R.B. at 34-35. This is an interesting argument in light of the nature of MEI's petitions to modify its EEPA. MEI is wrong. The calculation of its EEPA rate is incorrect. WPP should have used Step 8 and inserting it now is a correction, not a hindsight

modification. I recommend that the MEI EEPA capacity rate be reduced from 3.3¢/Kwh to 3.12¢/Kwh. This assumes the Commission resuscitates the MEI EPA which has lapsed. *See* discussion in Section IV A below.

8. *Capacity Costs Allocated on a Demand/ Energy Basis*

Presently, QF capacity payments are recovered from ratepayers through the ECR on a straight energy basis and, therefore, allocated to WPP's customers on the same basis. AAL and WPPII advocate for recovery of QF capacity payments from ratepayers on a Kw demand basis through the ECR but in a manner similar to that which would have occurred if such capacity had been built by the utility and the costs were included in base rates and allocated according to cost-of-service principles. AAL M.B. at 79-86; WPPII M.B. at 20-25.

Noting that were WPP to construct the avoided units (base load coal units), the costs would be allocated in base rates on a demand basis, AAL witness Baron recommends that the long term capacity purchases from the three Projects be accorded the same rate treatment. He suggests use of the same demand allocation method used by WPP in its most recent cost-of-service study, updated to the 12 month period ended June 30, 1986. AAL St. 2 at 24. Although the June 30, 1986 12 month period represented the most recent information available, Mr. Baron strongly encouraged WPP to update its analysis with recent data since the cost-of-service information is a number of years old. AAL St. 2 at 28.

The reasons for using a demand/energy allocation are sound. First, as long as rate recovery is accomplished through the ECR, the method of allocating QF purchase costs to the ratepayers will have no effect on the amount of revenue collected by the utility and passed through to the QF. Second, without a demand allocation of capacity payments ratepayer indifference is lost because high

load factor customers (usually energy intensive customers such as the members of AAL and WPPII) pay higher rates for cogenerated capacity than for utility generated capacity. Third, the current practice of recovering QF capacity payments through the ECR is contrary to accepted cost-of-service ratemaking principles.

OCA recommends that AAL's proposal be rejected. OCA M.B. at 88-92. OCA argues first that the AAL rate structure proposal would add complexity to the calculation and charging of WPP's ECR.

Second, OCA argues that AAL's proposal is based on the inaccurate assumption that QF capacity rates should be allocated based upon a single WPP coincident peak, the method used in the last WPP case. Tr. 687-688. OCA points out, however, that in R-850220, the last WPP rate case, the rate increase was allocated on an energy basis for Bath County costs and a rate reduction related to non-Bath County was also allocated on an energy basis. Tr. 689-90. Also in R-842632 the Commission rejected a staff proposal to use only the coincident peak method. *Pa. PUC v. West Penn Power Company,* 59 Pa. PUC 552, 609 (1985).

Third, OCA agrees with WPP witness Binder that the AAL method of allocating capacity related costs based upon a single coincident peak may result in volatile changes in cost allocations depending upon peak responsibility for a single day. Tr. 1031. Also, Mr. Baron agreed that the cost responsibility allocations provided in the next West Penn base rate case may also indicate the need for additional changes in cost allocations based upon new cost data. Tr. 697-98, 703.

Finally, OCA notes that the rate structure issue is not one which the Commission has set for decision in this case and may be analyzed more appropriately in future base rate or ECR proceedings.

In my opinion, AAL and OCA are both correct. The capacity costs should be flowed through to WPP rate-

payers, via the ECR, on a demand/energy basis, but the allocation should not be set in this proceeding. Any complexity brought to the ECR calculation is outweighed by the true reflection of costs which will result.

It is clear from this record that the current method of using the ECR without a demand/energy allocation discriminates between classes of customers and does not meet the PURPA-mandated standard of customer indifference to the source of capacity. *In re: Middle South Services, Inc.*, 71 PUR. 4th 580, 594, 33 FERC ¶ 61.408 (1985). There is precedent for a demand/energy allocation. The West Virginia Commission allocates the QF capacity costs of Monongahela Power Company (WPP's sister utility) on a demand basis within the fuel adjustment clause. Also, the Virginia State Corporation Commission, in Case No. PUE-880052, concluded that QF capacity costs should be recovered through base rates on a demand/energy basis. AAL St. 2 at 26-27. AAL's method, is flawed, however, because the single coincident peak method has not been used in past WPP rate cases, because it may result in volatile changes in cost allocations, and because Mr. Baron used stale data.

Because the costs in question will not be recovered through WPP's ECR until the next ECR proceeding, and because AAL's method and data are flawed, this is not the appropriate proceeding in which to set the demand/energy allocation. It is the proceeding, however, in which to declare that capacity costs for WPP's QF purchases should be flowed through to WPP ratepayers via WPP's ECR on a demand/energy basis and I so recommend. I recommend also that WPP be directed to make such an allocation, as part of its next ECR filing and that all existing on-line QF capacity at the time of the filing be included. Under Section 1307 of the Code, 66 Pa. C.S. § 1307, the Commission has the authority to direct WPP to do this. To extend this ruling to other electric utilities, however, must await a separate proceeding. It could

be done in the generic cogeneration investigation (I-860025) where the Commission is considering the issue of demand/energy allocations through the ECR.

9. *Excess Capacity*

In its MEI Petition, WPP asks the Commission to find that addition of the MEI capacity "does not result in excess capacity under Section 1323 of the Public Utility Code as to the MEI capacity itself or as to any *existing* West Penn capacity". West Penn Petition at 5-6 (emphasis added). In its Order of September 22, 1987 granting rate approval to West Penn concerning the Milesburg project, the Commission stated that: "the Commission hereby declares that additional generation capacity as a result of the contract between West Penn Power Company and Milesburg Energy, Inc., referenced in ordering Paragraph No. 1, above, shall not be considered by the Commission in determining the reserve margins or economic benefits resulting from *any base load or other generating unit during the terms of the contract.*" Order at 7 (emphasis added).

The Commonwealth Court held that the "Commission may not make such a decision without first providing the ratepayers with notice and hearing." *Milesburg* at 1308. By the Court's remand, therefore, the excess capacity issue, as it applies to all four EEPA Petitions, must be addressed here.

The OCA submits that in this proceeding the Commission should adopt a policy concerning any further excess capacity adjustments to be made on the WPP System. The OCA also asks the Commission to declare that QF capacity *will* be considered in determining whether *subsequent* utility plant additions represent excess capacity. OCA M.B. at 82-87.

Mr. Biewald presented testimony upon the issue of how capacity provided by QFs should be taken into account when determining whether excessive capacity exists

upon a utility system. OCA St. 1 at 68-76. He generally distinguished between excess capacity determinations which take into account generating capacity constructed before and after the utilities' commitment to a QF generating resource. OCA St. 1 at 72-76. Mr. Biewald stated that it is essential to consider QF capacity in deciding whether utility capacity constructed *after* the utilities' commitment to a QF should result in an excess capacity determination. He explained that to do otherwise would double charge ratepayers for QF capacity as they would pay once for the actual QF and once again for excess utility capacity that was to have been avoided by the QF. The utility should not be permitted to charge ratepayers for capacity when it is clear from the generating resources available to it (excluding QFs) that such additional capacity is not required. Mr. Biewald concludes that:

> Thus we reach a very simple conclusion: at least some excess capacity analyses, namely those concerning future utility resource additions, must treat QF capacity in *exactly the same manner as utility-owned capacity*.

OCA St. 1 at 73 (emphasis in original).

Mr. Biewald rejected the Commission's Proposed Policy Statement, issued for comment in the *Pennsylvania Bulletin* on July 18, 1987 at Docket No. L-870030, which declared that QF capacity ought to be included in excess capacity evaluations, only where utilities imprudently bring capacity on line when the existence of the QF would have permitted delay or cancellation.

The OCA submits that the Commission should make clear in these proceedings that it does not intend to adopt its Proposed Policy Statement. The reasons in support of OCA's position appear in OCA M.B. at 85-87. I do not summarize them here because these are not the correct proceedings in which this determination should be made. Comments to the Proposed Policy Statement have

been filed and a final Commission determination is pending in that proceeding (L-870030). While the Commission might or might not choose to follow its proposed policy in these proceedings, a blanket determination is proper in the proposed policy proceeding, not here.

I recommend a finding that addition of the QF capacity in question does not result in excess capacity under Section 1323 of the Code as to the capacity itself or as to any existing WPP capacity.

10. *Capacity Rate Recommendation*

Based on the above discussion I recommend approval of the Monongahela EEPA at an initial energy rate of 3.8¢/Kwh and a capacity rate of 3.6¢/Kwh. I recommend approval of the Burgettstown EEPA at an energy rate as described and applied in Section 1.2 of that EEPA and a capacity rate of 3.6¢/Kwh. I recommend approval of the Shannopin EEPA at an energy rate as described and applied in Section 1.2 of that EEPA and a capacity rate of 4.0¢/Kwh. The rates for Burgettstown assume that the Commission adopts my recommendation, discussed below, to deny the Burgettstown Petition to extend deadlines and to update capacity rates.

I recommend that the Milesburg Petition be denied for the reasons discussed below. If the Commission rejects my recommendation, I recommend that the capacity rate be reduced in accordance with the discussion at Section III D 6 above.

I recommend that WPP be directed to include in its next ECR filing a demand/energy allocation for all QF capacity on-line at the time of the filing of the ECR.

PHASE TWO PROCEEDINGS

IV. THE PETITIONS FOR MODIFICATION

The second phase of these proceedings consists of a hearing to consider two petitions filed pursuant to Section 508 of the Code, 66 Pa. C.S. § 508 which reads as follows:

> Power of the commission to vary, reform and revise contracts
>
> The commission shall have power and authority to vary, reform, or revise, upon a fair, reasonable, and equitable basis, any obligations, terms, or conditions of any contract heretofore or hereafter entered into between any public utility and any person, corporation, or municipal corporation, which embrace or concern a public right, benefit, privilege, duty, or franchise, or the grant thereof, or are otherwise affected or concerned with the public interest and the general well-being of this Commonwealth. Whenever the commission shall determine, after reasonable notice and hearing, upon its own motion or upon complaint, that any such obligations, terms, or conditions are unjust, unreasonable, inequitable, or otherwise contrary or adverse to the public interest and the general well-being of this Commonwealth, the commission shall determine and prescribe, by findings and order, the just, reasonable, and equitable obligations, terms, and conditions of such contract. Such contract, as modified by the order of the commission, shall become effective 30 days after service of such order upon the parties to such contract.

The reader is referred to the History of the Proceedings (Section I above) which relates in part to these petitions and which is not repeated in its entirety here.

A. *MEI's Petitions*

Currently pending in Phase Two of these proceedings are four separate but related Petitions and Motions: 1) the February 8, 1989 Petition for MEI for Modification of An Electric Purchase Agreement; 2) the March 14, 1989 WPP Petition for Leave to Withdraw its original Petition; 3) the March 13, 1989 Motion of AAL to Dismiss the original WPP Petition seeking rate recovery for the costs incurred under the WPP/MEI Agreement; and 4) the May 12, 1989 Petition of MEI for Modification of Petition to Modify Electric Purchase Agreement. The March 3, 1989 Petition of MEI for the Issuance of an Interim Emergency Order or Appeal was denied by Commission Order entered March 31, 1989.

MEI's February 8, 1989 Section 508 Petition requested that the Commission modify MEI's privately negotiated contract with WPP in two ways: 1) to increase the levelized capacity cost rate contained in the Agreement to reflect a delayed in-service date for the project (now anticipated to be in mid-1993. MEI St. 5), or in the alternative, to approve a non-levelized capacity rate; and 2) to extend the Agreement's Financing Closing Date to not later than 120 days after a final and nonappealable Order of the Commission giving approval for recovery of all energy and capacity costs, and all other milestone dates as appropriate.

MEI advances several arguments in support of its position. First, extension of the milestone dates is reasonable, fully supported and justified because:

a) of extensive and unprecedented delays due to litigation of the reasonableness of the EEPA before the Commonwealth Court and the Commission;

b) the Consent Agreement issued by the Commission on September 1, 1988 shows that all parties recognized a likelihood of further extension of the milestone dates;

c) extension of the milestone dates is essential to survival of the MEI Project;

d) in its March 31, 1989 Order, the Commission stated that the EEPA "could be reinstated by extending the financing deadline *nunc pro tunc*, for example, by modifying the contractual provision so that it is not self-executing." Order, at 8.

e) failure of the Commission to modify the EEPA would curtail cogeneration development in Pennsylvania;

f) MEI will suffer a financial loss of millions of dollars without extension of the milestone dates;

g) the Commission recently enunciated a policy of encouraging the extension of contractual milestones in *Petitions of Pennsylvania Electric Company*, P-890353, P-890354 (Opinion and Order entered April 6, 1989);

h) WPP requested MEI to agree to EEPA modifications by letter of February 13, 1989 but WPP refused MEI's request to modify the EEPA despite MEI's requests and the ALJ asking WPP if it would agree to voluntary negotiations on the EEPA (at the March 31, 1989 prehearing conference);

i) the MEI project will benefit the citizens of Pennsylvania and the local community;

k) extending the milestone dates will produce no demonstrable risk to WPP's ratepayers and will not cause planning uncertainty on WPP's system;

l) extending the dates will not result in payments in excess of avoided costs and will not discriminate against other QF's.

Second, modification of the capacity rates from 3.3¢/Kwh to 4.9¢/Kwh is reasonable and justified because:

a) without it the project cannot survive because since the Commission approved the Project in September, 1987, interest rates and the cost of construction and borders has risen substantially;

b) the modification requested by MEI is not in excess of WPP's avoided cost;

c) under the circumstances of this case it is inappropriate to update all of WPP's assumptions because MEI is asking only for an update of the in-service date of the project;

d) MEI's request will not result in uncertainty for financing entities;

e) MEI's request will not cause widespread use of regulatory out clauses (requiring utility payments to QFs only if the utility receives money from its ratepayers for that period).

The testimony and exhibit references as well as the full argument of the Projects in support of the above appear at pages 66 to 84 of the BM&S Main Brief. MEI's arguments are not discussed further because the MEI contract has lapsed and cannot be changed under Section 508. Even so, many of the issues raised by MEI's petition are similar to the Burgettstown Petition and are discussed in Section IV B below.

One of the key original provisions in the EEPA between WPP and MEI, Section 10.2, provided as follows:

> "If the Financing Closing Date shall not occur prior to September 1, 1988 for any reason whatsoever, including *Force Majeure*, this Agreement shall automatically terminate in which case neither party shall have any further liability to the other hereunder."

Immediately before the September 1, 1988 automatic termination of the Agreement under Section 10.2, the parties to the Milesburg proceeding entered into a Consent Agreement which resulted in a Consent Order issued by the Commission on September 1, 1988. AAL Ex. 80.

This Consent Order extended the September 1, 1988 Financing Closing Date to February 28, 1989 and provided as follows:

> The Financing Closing Date set forth in Section 10.2 of the Agreement is hereby extended to and including February 28, 1989, and any other dates, including the earliest possible commencement date, in the said agreement that is dependent on the said Financing Closing is extended for a like period. *Should the Financing Closing Date not occur on or before February 28, 1989, the Agreement will automatically terminate pursuant to Section 10.2, unless otherwise extended by further order of this Commission.* (emphasis added)

The Financing Closing Date was not extended by further order of the Commission before February 28, 1989 because MEI did not file its petition soon enough for Section 508 to be used to modify the EEPA before the deadline. The question before me, therefore, is whether Section 508 empowers the Commission to retroactively reinstate the MEI EEPA which automatically terminated under its own terms.

WPP, AAL and WPPII argue that because the contract MEI seeks to modify has lapsed, there is no contract to modify and Section 508 does not apply. WPP M.B. at 79-80; AAL M.P. at 88-89; WPPII M.B. at 26-27.

In my view, this is a contractual issue because Section 508 gives the Commission the "power and authority . . . to vary, reform, or revise . . . any terms, or conditions . . . of any *contract* . . . between any public utility and any . . . corporation" (emphasis added). There is no contract between WPP and MEI upon which the power vested in the Commission by Section 508 can operate. Section 508, therefore, is inapplicable here. MEI does not address this point and it has advanced no legal authority to support the retroactive modification of a contract which no longer exists.

In its Order entered March 31, 1989 denying MEI's Emergency Petition, the Commission stated with respect to MEI's Section 508 Petition that "should MEI prevail, the Electric Energy Purchase Agreement between MEI and West Penn could be reinstated by extending the financing deadline *nunc pro tunc,* for example by modifying the contractual provision so that it is not self-executing." Order at 8. The proper function of a *nunc pro tunc* order, however, is to make the record speak the truth. Such an order corrects the record so that it truly reflects an action really taken, but which through some inadvertence or mistake has not been recorded. *In re: Jurkowitz Estate, Pa.,* 59 A.2d 895 (1948); *Matthies v. Railroad Retirement Board,* 341 F.2d 243 (8th Cir. 1965). *See also* 2 Am. Jur. 2d, Administrative Law § 521. In my opinion, the Commission's observation about the application of the doctrine of *nunc pro tunc* is incorrect because there is no existing Commission judgment before February 28, 1989 to be corrected by the doctrine. Even if the consent order could be considered as a Commission judgment, an order *nunc pro tunc* would be inappropriate because there is no mistake in the consent order and nothing was inadvertently omitted from it.

I note also that the Consent Order specifically precludes higher capacity payments. Paragraph 3 of the Consent Order reads as follows:

> MEI shall not seek nor be entitled to any capacity credit higher than that specified in the Agreement executed on or about February 25, 1987.

AAL Ex. 80. I reject MEI's argument that the consent order does not bar increased capacity rates. MEI argues that because the modified rates are below the rates which would be calculated under WPP's methodology or the regulations, these do not represent an increase in rates. BM&S R.B. at 47-48. It *does* represent an increase in

capacity rates. MEI's petition should be denied for this reason also.

MEI argues that the legally enforceable obligation of WPP to purchase energy from MEI is not dependent on the existence of a contract. The obligation exists pursuant to PURPA which requires the utility to purchase energy from a QF at rates as of the time that there is a legally enforceable obligation, as defined by state law. (45 Fed. Reg. 12224). According to MEI, WPP misreads 18 C.F.R. § 292.304(d) as requiring this proceeding to be viewed strictly under contract law. That section refers to the utility's legal obligation to purchase from the QF, whether or not a contract is in effect. The QF has the option, before commencement of the term of the agreement, to choose whether it wants its avoided cost payments based on time of delivery or the time the obligation is incurred. (18 U.S.C. § 292.304(d)(2)(i) and (ii)). MEI concludes that, in Pennsylvania, WPP is compelled to purchase from MEI from the time serious negotiations took place. For MEI, that obligation was formed by May, 1986 or earlier. BM&S R.B. at 46.

While it appears that WPP is required by PURPA to purchase power from MEI, WPP is not required to do so under the lapsed EEPA. To require WPP to purchase its power, MEI must file a petition with the Commission to set rates as of the time of serious negotiations *under the provisions of the Commission's PURPA regulations.* MEI's argument does not resuscitate the lapsed contract.

It is clear that the MEI Project would be beneficial to the Commonwealth. It will allow for the reclamation of land on which coal waste is stored. It will provide needed employment in the Belefonte area, perhaps improve water quality there, help pay for part of the improvement of a railroad bridge and provide business for a local railroad company. MEI St. 4. It is also clear that MEI could not have foreseen the delays caused by litigation. This is a risk that any developer must bear,

however. Despite the obvious equities in favor of the MEI Project, the EEPA does not exist and cannot be approved. If the Commission disagrees, the EEPA should not be modified for the reasons given above and in section IV B below.

I recommend that MEI's Petition for modification be denied and that WPP's Petition to withdraw and AAL's Petition to dismiss be granted. That leaves MEI's May 12, 1989 Petition to modify its petition to modify.

MEI's May 12, 1989 Petition is a petition to modify a petition to modify a contract that no longer exists. MEI's Petition seeks the same type of modification sought by North Branch. *See* Section IV B below. Through it MEI seeks to avoid business risks which it voluntarily accepted in the EEPA. A discussion of the merits of the May 12, 1989 Petition is unnecessary because the underlying contract, the EEPA, has lapsed and cannot be modified. I recommend that MEI's May 12, 1989 Petition be denied for this reason and for the same reasons for which the Burgettstown Petition should be denied.

B. *The Burgettstown Petition*

As in the MEI Petition, the North Branch Petition (for the Burgettstown Project) is in two parts. First, it asks for modification of milestone dates and second, it asks for an increased capacity rate to reflect the new in-service date. This discussion will also refer to the Milesburg Petition because the issues raised by both Petitions are similar, even though the MEI EEPA has lapsed.

In the Burgettstown EEPA, the capacity credits are based on the QF being placed in service on October 1, 1991. If it is not placed in service by October 1, 1993, Burgettstown will be in default. Based on those dates, Burgettstown is to have a financial closing on October 1, 1989 and is to make a final good faith deposit of $360,000 on July 1, 1989. According to North Branch, the developer of the Burgettstown Project, these dates

were agreed to on October 15, 1987 based on a belief that the pass-through provisions of the EEPA would be ruled on favorably by the Commission as was done in the Milesburg Project (by order entered September 22, 1987). After that, however, appeals were filed with the Commonwealth Court which resulted in a decision that bill insert notice needed to be sent to ratepayers and due process hearings needed to be held. Due to those unforseen circumstances, North Branch notes, there has been a year and a half period during which no meaningful engineering, financing or construction activity could take place.

Due to this delay, North Branch filed its petition for modification so that, according to North Branch, the now unrealistic milestones in the Project may be modified so as not to jeopardize the project while, at the same time, protecting WPP's generation planning study.

Mr. Brooks testified that construction of the plant from the date of financial closing would take approximately 33 months. Tr. 1368. This testimony was not rebutted. Mr. Hoehler testified that it would take approximately six months from the date of a final order to have a financial closing. Thus, assuming that a final unappealable order were to be issued in this case on October 1, 1989, a closing could not be held until approximately April 1, 1990 and the plant could not be constructed and placed in service until approximately January 1, 1993. North Branch concludes that if its Project is to be approved, the contract dates must be modified. BM&S M.B. at 85.

Paragraph 18 of the North Branch Petition sets forth the specific EEPA modifications requested and reads as follows:

> 18. Due to the delay caused by the intervenors, the following dates in the Agreement must be modified as follows:

a. "Financial Closing Date" shall be defined as six (6) months from the date of a final order in this proceeding.

b. The second sentence of Section 2.1 of the Agreement shall be modified to read as follows:

"The parties currently estimate that with the exercise of such diligence Seller shall be able to place the Project in service at the Contract Output no later than thirty three (33) months from the Financial Closing Date.

c. Section 6.1(a) shall be modified to change the event of default date as follows:

(a) the Commencement Date shall not occur prior to fifty-seven (57) months from the Financial Closing Date or October 1, 1995 whichever is earlier.

d. The final Good Faith Deposit of $360,000 shall not be due until three (3) months prior to the Financial Closing Date.

e. All dates which relate to the above dates shall be adjusted automatically.

f. The capacity credit shall be modified to be the avoided capacity credits calculated pursuant to West Penn's PURPA 210 filing of July 31, 1986 and calculated as of the modified in service date in Section 2.1 of the Agreement which is set forth in subparagraph 18b. hereof.

The parties have litigated this issue thoroughly. BM&S M.B. at 87-89, R.B. at 35-49; WPP M.B. at 81-87, R.B. at 32-46; AAL M.B. at 95-99, R.B. at 46-48; OCA M.B. at 93-97, R.B. at 31-32.

I note first that although the North Branch Petition seeks a modified capacity credit based upon WPP's July 31, 1986 PURPA filing with the Pennsylvania Commission, the supplemental testimony of Mr. Ross on behalf of Burgettstown (Burgettstown St. 7) does not calculate a modified capacity credit on that basis. Instead, Mr. Ross calculates increased rates based upon the WPP method for calculating avoided costs under the assumption of a later in-service date for the QF. There is, therefore, no testimony to support the capacity rates requested in North Branch's Section 508 Petition. The North Branch Petition does not specify a requested capacity credit, and the supplemental testimony of Mr. Ross sets forth an increased capacity credit based upon a methodology which is different than that requested in the Petition. There is no way of knowing, therefore, what rate North Branch is requesting. The Petition should be denied for this reason. There are, however, other reasons why the Petition should be denied.

The North Branch Petition requests an open-ended modification of the Financial Closing Date (six months from the date of a final order in this proceeding, instead of October 1, 1989); requests an open ended in service date (no later than 33 months from the Financial Closing Date, instead of between April 1, 1991 and October 1, 1991); requests an open ended event of default date (57 months from the Financial Closing Date or October 1, 1955 whichever is earlier); and requests that all related dates be adjusted automatically. This is unlike the February 9, 1989 MEI petition which requests extension of the Financing Closing Date to no later than 120 days after a *final and nonappealable order of the Commission.* North Branch's extension is not predictable. It is doubtful that any appeals taken from the Commission's Order could be litigated within six months. This applies also to MEI's May 12, 1989 Petition.

North Branch cites *Petition of Pennsylvania Electric Company Re: X10X Corporation,* Docket Nos. P-89035

and P-890354 (April 6, 1989) as enunciating the Commission's policy of encouraging voluntary extensions of financing and/or commercial operation or related deadlines. It suggests that WPP's actions are contrary to that policy. BM&S M.B. at 43. But, as WPP points out, the Commission also observed that orderly capacity planning is a legitimate concern of utilities:

> Our discussion should not be read as discouraging utilities from utilizing *reasonable* milestone dates in their contracts with qualifying facilities. A concern independent of the reasonableness of rates paid to qualifying facilities is the need by a utility to plan its capacity additions to match its anticipated load growth.

Opinion and Order, April 6, 1989, at 7 (emphasis in original).

The question to be resolved is whether WPP's refusal to agree to the extensions is motivated by lack of support for the projects (this issue applies to Milesburg also, if the Commission resuscitates the MEI EEPA) or whether it is motivated by the desire to avoid significant planning uncertainties and impairment to its ability to serve its customers if the projects fail to go into commercial operation. Resolution of this issue turns on the risks to be borne by the parties.

WPP's Main Brief, pages 60-67 contains an excellent discusison of the dynamics of the lengthy and complex negotiation process leading to the EEPAs and how the EEPAs address how the risks are to be borne by all affected parties, including the project lenders, constructors, operators, WPP and its customers. I have attached these pages as Appendix A and incorporate them herein.

Many observers are concerned that electric utilities are hostile toward cogeneration because it impairs their control over their generation, generation planning and return on rate base. The record in this proceeding does

not demonstrate this hostility, if it exists generally, on the part of WPP or APS. What the record does demonstrate is a deep concern on the part of both that the EEPAs allow them to insure that, at important stages of development, the project is progressing and that if it is not they can take steps to safeguard their system reliability and generation needs. This is vital in light of WPP's duty to serve the public under Section 1501 of the Code, 66 Pa. C.S. § 1501. The Projects argue that the contract was not truly negotiated because WPP was inflexible regarding the EEPA. The record does not demonstrate this. Also, if the Projects felt that way they could have opted to sell their power to WPP under the Commission's regulations.

WPP did grant a limited extension to MEI in the Consent Order entered by the Commission on September 1, 1988. The extension requested by North Branch for the Burgettstown Project, and by MEI, however, are not for short, limited periods of time at the price originally negotiated. Instead the developers request prolonged extensions covering periods much beyond those originally negotiated by the parties and at increased capacity rates. This changes the planning risk WPP negotiated in the EEPAs.

WPP witness Albert Kave testified that the planning risks associated with reliance on a proposed QF project decrease significantly at two points: at the time of agreement in principle on purchase rates and at the time of the financial closing. WPP St. 1 at 9; WPP St. 4 at 5; Tr. 83-86 and 297. Neither of these projects have had a financing closing and the proposed extensions provide no assurance that a financing closing date will occur within a reasoable period of time. The proposed cutoff date for the Burgettstown project's in-service date of October 1, 1995 (as well as the cutoff date of January 1, 1995 recently proposed for the Milesburg project in MEI's May 12, 1989 Petition) does not provide WPP with enough planning certainty regarding these projects.

WPP would have insufficient time before its planned need for capacity to replace these projects if they should fail to go into service by the proposed cutoff dates. The extensions would push the Burgettstown financial closing deadline to as late as late 1992 or early 1993 because construction of the project will take at least 30 to 33 months. Tr. 1368, 1400. Judging from the history of these proceedings there is the likelihood that a party or parties will seek review of the Commission's final order in the Pennsylvania courts and perhaps in the federal courts. If so, it is highly unlikely that either MEI or North Branch will meet any of the extended deadlines. This further increases the risk to WPP and its ratepayers that WPP will be unable to arrange alternative sources of power.

It can be argued that even without the increased capacity rates, the extensions benefit WPP ratepayers because of the postponement of payments. It would be useless to approve the extensions without the increased rates, however, because the developers have made it clear that without both, the projects will fail.

The developers argue that the extensions are needed because they have spent millions of dollars on the projects and because the projects are in jeopardy owing to the delays in these proceedings resulting from *Milesburg*. The amount of money spent on the projects does not mean they will go into service. The developers were always at risk that, no matter how much money they spent, WPP's obligation under the EEPAs would cease upon a missed milestone date. *See* AAL Ex. 11, Sections 5.7 and 10.2; AAL Ex. 24, Sections 5.7 and 10.2. It is clear that the business "deal" between WPP and the developers placed the risk of construction related cost increases on the developers at all times, even if those cost increases were to render the projects infeasible.

The delays in Commission approval of the EEPAs, while the fault of neither WPP or the developers, is a

risk to which the developers have always been subject. Even so, the developers are requesting a higher capacity rate to offset cost increases which occurred during the delays. It is incorrect to shift this burden to the ratepayers because it was not part of the original business arrangements, the EEPAs. The developers' petitions should be denied for this reason.

Another reason for denying the petitions is the lack of consistency. The time frame argument of the cogenerators in Phase One above favors the time of serious negotiations for the following reasons, enunciated at BM&S Main Brief at 34-35:

> Mr. Ross testified that "it is inappropriate and inequitable for the parties who have negotiated an EEPA in good faith, *based on the circumstances occurring during the time that serious negotiations were taking place, to be held accountable for knowing the outcome of the future events.*" (BM&S, St. 1 at 17-18). If a QF and a utility agree on rates based upon projections of a utility's avoided cost as of the time of serious negotiations, *and those rates are later modified to reflect changed circumstances* . . . the economic feasibility of the project as well as the goal of PURPA will be frustrated.
>
> * * * *
>
> The projects have *refrained from using hindsight* by not extracting data from a time period other than the time of serious negotiations by each party (emphasis added).

In Phase Two, however, Burgettstown and MEI argue for higher capacity rates to reflect changed circumstances existing in 1989. It is inconsistent for the cogenerators to argue on one hand that TRA-86 should not be considered in calculating avoided costs while arguing on the other hand that negotiated capacity payments should be increased because of unforeseen events occurring in 1989, which events delayed the project in-service dates.

If the developers are permitted to modify the negotiated EEPAs here because of unforseen events, the contracts between WPP and the cogenerators become meaningless. Such a decision will lead to a reluctance of utilities to negotiate such contracts in the future. Of course, the denial of modifications should work both ways. That is, if avoided costs decrease after a contract is signed, the utility should not be allowed to modify the contract to reduce the capacity costs. Such a policy instills consistency and predictability in the utility/QF relationship which should foster the growth of reliable QF projects.

I recommend that, for the above reasons, the North Branch Petition be denied. The above reasons also support denial of the MEI Petition, denied above for other reasons.[14]

C. *Notice to Ratepayers*

AAL argues that WPP was required under Section 508 of the Code to send out notices that a rate modification was requested and that the notice which was sent previously to WPP's ratepayers is insufficient. AAL M.B. at 93-95, 98. I discuss this issue, even though modification is denied above, because it is relevant to future proceedings.

At times a utility changes the level of its Revenue Requirement during a base rate proceeding owing to data updates. A new notice is not required because the original notice is sufficient to notify all interested parties of the prospective change in rates and gives them an opportunity to participate. WPP's bill inserts accomplished the same purpose. The modification requests here are no different than a changed level of rate relief in a base rate proceeding. Accordingly, neither MEI nor North Branch were required to issue new notices.

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[14] North Branch and MEI can resort to the Commission's regulations to sell their power to WPP.

V. RECOMMENDED ORDERS

I recommend that the Commission issue four separate orders in these proceedings. No apeal from the Monongahela Petition is possible if the petition is approved as applied for because no party contested that petition. Including all petitions in one order, however, could delay the Monongahela Project unnecessarily if any party appeals from the Commission's Order.

A. *Recommended Milesburg Project Order*

Therefore,

IT IS ORDERED:

1. That the Petition of West Penn Power Company at Docket No. P-870216 to withdraw its Petition at Docket No. P-870216 for approval of an Electric Energy Purchase Agreement entered into with Milesburg Energy, Inc. (for the Milesburg cogeneration project) is granted.

2. That the Petition of Milesburg Energy, Inc., filed February 9, 1989 for modification of the Electric Energy Purchase Agreement referenced in paragraph 1 of this order is denied.

3. That the Petition of Milesburg Energy, Inc., filed May 12, 1989, for modification of the Petition referenced in paragraph 2 of this order is denied.

B. *Recommended Monongahela Project Order*

Therefore,

IT IS ORDERED:

1. That the Petition of West Penn Power Company at Docket No. P-880283 for approval of an Electric Energy Purchase Agreement entered into with Noah Corporation (for the Monongahela Lock and Dam No. 8 cogeneration project) is granted.

2. That the rates set in the Electric Energy Purchase Agreement are just and reasonable.

3. That upon the occurrence of all conditions precedent in the Electric Energy Purchase Agreement, West Penn Power Company is authorized to pass through to its ratepayers by way of its Energy Cost Rate all charges resulting from the Agreement.

4. That in its next Energy Cost Rate filing, West Penn Power Company allocate all of its charges under cogeneration projects on-line as of the date of filing of the Energy Cost Rate on a demand/energy basis.

5. That the addition of capacity West Penn Power purchases under the Electric Energy Purchase Agreement does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn Power Company capacity.

C. *Recommended Burgettstown Project Order*

Therefore,

IT IS ORDERED:

1. That the Petition of West Penn Power Company at Docket No. P-880284 for approval of an Electric Energy Purchase Agreement entered into with North Branch Energy Partners, L.P. (for the Burgettstown cogeneration project) is granted.

2. That the Petition of North Branch Energy Partners, L.P. for modification of the Electric Energy Purchase Agreement referenced in paragraph 1 of this order is denied.

3. That the rates set in the Electric Energy Purchase Agreement are just and reasonable.

4. That upon the occurrence of all conditions precedent in the Electric Energy Purchase Agreement, West Penn Power Company is authorized to pass through to its ratepayers by way of its Energy Cost Rate all charges resulting from the Agreement.

5. That in its next Energy Cost Rate filing, West Penn Power Company allocate all of its charges under

cogeneration projects on-line as of the date of filing of the Energy Cost Rate on a demand/energy basis.

6. That the addition of capacity West Penn Power purchases under the Electric Energy Purchase Agreement does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn Power Company capacity.

D. *Recommended Shannopin Mine Project Order*

Therefore,

IT IS ORDERED:

1. That the Petition of West Penn Power Company at Docket No. P-880286 for approval of an Electric Energy Purchase Agreement entered into with Mon Valley Energy Corporation (for the Shannopin Mine cogeneration project)is granted.

2. That the rates set in the Electric Energy Purchase Agreement are just and reasonable.

3. That upon the occurrence of all conditions precedent in the Electric Energy Purchase Agreement, West Penn Power Company is authorized to pass through to its ratepayers by way of its Energy Cost Rate all charges resulting from the Agreement.

4. That in its next Energy Cost Rate filing, West Penn Power Company allocate all of its charges under cogeneration projects on-line as of the date of filing of the Energy Cost Rate on a demand/energy basis.

5. That the addition of capacity West Penn Power purchases under the Electric Energy Purchase Agreement does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn Power Company capacity.

Date: June 8, 1989 /s/ Larry Gesoff
LARRY GESOFF
Administrative Law Judge

APPENDIX M

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17120

Docket No: P-870216, P-880283, P-880284, P-880286

Public Meeting—September 21, 1989
SEP-89-ALJ-124 *

PETITION OF WEST PENN POWER COMPANY (WPP) FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS (EEPAS) AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASED POWER COSTS RE: MILESBURG ENERGY, INC.; MONONGAHELA LOCK & DAM NO. 8; BURGETTSTOWN PROJECT AND SHANNOPIN MINE PROJECT

MOTION OF CHAIRMAN BILL SHANE

Before the Commission for disposition is Administrative Law Judge (ALJ) Larry Gesoff's Recommended Decision in the above captioned proceedings.

After thoroughly reviewing the ALJ's Recommended Decision (R.D.) and the Exceptions and Reply Exceptions filed thereto, I believe we should adopt the ALJ's Recommendation regarding "Phase I" issues, with minor modification, and reverse the ALJ's recommendations concerning "Phase II."

Phase I

1. *The reasonableness of rates in negotiated contracts generally is to be judged by a comparison to rates that would be required under the Commission's regulations. R.D. at 38-41.*

This is a fundamental concept that has been the basis for all of the Commission's Orders approving rate recovery of amounts to be paid to Qualifying Facilities (QFs) under negotiated agreements. The methodology in the Commission's regulations is binding upon all in Pennsylvania unless and until the Commission revises it as a result of the general investigation at Docket No. I-860025.

This finding should be adopted *and strengthened* by a more vigorous defense of the capacity credit formula at 52 Pa. Order § 57.34(c).

2. *The reasonableness of the capacity credits in the instant proceedings is to be judged by a comparison to rates that would be required under West Penn's methodology, R.D. at 41-42.*

The only evidence regarding credits under Commission's regulations submitted in the instant proceeding was testimony by West Penn witness Kave. All parties are in basic agreement that West Penn's methodology is appropriate, although various "inputs" into the methodology were challenged. Therefore, as a practical matter, I believe that the ALJ's finding in this issue be adopted, with the *addition of express language* noting that West Penn's methodology results in lower capacity credits than an application of the Commission's regulations; therefore, since credits under the Commission's regulations would be *per se* reasonable, it follows that credits calculated under West Penn's methodology are *per se* reasonable as well.

3. *West Penn's avoided costs are to be determined as of the time that agreement in principle on rates was reached, which meets the definition of "serious negotiations", R.D. at 44-52.*

The Commission should adopt this portion of the R.D. as written, with the *addition of a caveat* that, if the evidence in this proceeding had demonstrated that West Penn had unreasonably delayed the issuance of project price proposals, the time frame of "serious negotiations" would

have been set as prior to the agreement in principle in rates. It is important that the Commission reiterate its position on time frame in a manner that prevents utilities from depriving QFs of avoided costs rate entitlement by delaying negotiations (see R.D. at 50).

4. *West Penn's projection that the next avoided unit would be a 300 MW base load coal unit, as opposed to a combustion turbine, was appropriate, R.D. at 71-80.*

The Commission should adopt this portion of the ALJ's R.D. with the *addition of language* at p. 80 *affirmatively stating* that the Commission agrees with West Penn that Allegheny Power System's (APS) load factor in conjunction with the volatility in the supply and price of natural gas and oil, the availability of economical sources of coal, and the public policy in Pennsylvania of encouraging the use of coal, supported West Penn's decision to add a coal unit as its next generating resource.

5. *Section 527 of the Public Utility Code does not mandate discounts from the full avoided cost standard of PURPA 210, R.D. at 95-97.*

The Commission should adopt the ALJ's R.D., with *language strengthening the conclusion.* Armco/Allegheny have in the past made superficially appealing but groundless arguments such as the Section 527 argument raised in this proceeding. I believe that strengthening this discussion is advisable.

6. *West Penn is directed to make a demand energy allocation of capacity charges as part of its next ECR filing, R.D. at 101-105.*

This rate structure issue is one that the Commission will have to address in the near future for all electric utilities that are flowing or that will begin to flow significant costs paid to QFs through the Energy Cost Rate (ECR) mechanism. The ECR mechanism allocates costs for fuel and purchased power strictly on an energy, or kwh, basis.

Whenever purchased power costs include payments for QF capacity, the ECR recovery mechanism is biased against high load factor, energy-intensive ratepayers (usually industrial ratepayers). If *utilities* build generating units and capital costs were recovered through *base rates,* costs would be allocated to customer classes on a demand/energy basis. Therefore, as utilities in the future begin to substitute purchases from independent power projects for their own construction, the rate structure issue takes on added importance. Ratepayers should remain indifferent to the source of supply as far as the allocation of costs is concerned. Thus far, arguments before the Commission in other ECR proceedings by industrial customers on this issue have received scant attention and met with little success. *See, e.g., Andrezeski v. Pennsylvania Electric Company,* Docket No. M-870172C001 *et seq.* (August 5, 1989) demand reallocation not appropriate at this time because demand component in Penelec's ECR is not large yet); *GPU Industrial Intervenors v. Metropolitan Edison Company* Docket No. M-870171C001 (August 15, 1989) (demand reallocation denied based on several factors and confusion regarding GPUII's proposals).

The ALJ's discussion up to the middle of page 104 should be adopted. However, the ALJ's statement at the beginning of the paragraph that the costs in question "will not be recovered through WPP's ECR until the next ECR proceeding" is in error. The costs in question will not be recovered for several years, after the projects are financed and constructed. Therefore, rather than ordering West Penn to make a demand/enegy allocation in the next ECR filing, I believe that the Bureau of Audits, with assistance from the Law Bureau, should be directed to prepare a recommendation for a future public meeting regarding the opening of a separate proceeding to address the rate structure issue. Depending on this recommendation, the Commission could issue a proposed regu-

lation applicable to all utilities *or* open a formal investigation into West Penn's ECR mechanism. Without input from Audits, I am unsure whether this issue should be handled generally or on a company-specific basis.

Phase II

A. *Milesburg*

The original financing date in Milesburg's contract of September 1, 1988 was extended to February 28, 1989 by a Consent Order signed by all parties and entered by the Commission on September 1, 1988. On February 8, 1989, Milesburg filed a Petition under Section 508 of the Public Utility Code, 66 Pa. C.S. § 508, requesting that (1) the financing date be extended to 120 days after a final and nonappealable Commission Order approving rate recovery, and (2) the capacity credit be increased from 3.3¢/kwh to 4.9¢/kwh to reflect the delay in the project's in-service date. Milesburg cannot go forward without an extension of the financing date, and avers that, since construction costs and interest rates have risen over time, the 3.3¢/kwh capacity credit can not longer support the project.

The ALJ recommended that Milesburg's Section 508 Petition be denied based on his finding that the contract between Milesburg and West Penn no longer exists due to the passing of the financing date. R.D. at 110-118. With respect to the request for an increase in the capacity credit, the ALJ found that the September 1, 1988 Consent Order specifically barred a capacity credit higher than that set forth in the contract. With respect to Milesburg's argument that the legally enforceable obligation of West Penn under PURPA 210 does not depend on the existence of a contract, the ALJ agrees, but states that "MEI must file a petition with the Commission to set rates as of the time of serious negotiations *under the provisions of the Commission's PURPA regulations*". R.D.

at 117 (emphasis in original). The ALJ concludes that, "[d]espite the obvious equities in favor of the MEI Project, the [contract] does not exist and cannot be approved." R.D. at 117. The ALJ recommends that West Penn's and Armco/Allegheny's petitions to withdraw/dismiss the Milesburg contract rate recovery petition be granted.

In my opinion, the ALJ's recommendation on these issues is in error, both legally and from a public policy perspective. First, regardless of whether or not the 1987 contract has lapsed, Milesburg is entitled to sell power to West Penn at rates based on West Penn's avoided cost projections in effect at the time of serious negotiations, as discussed above. Milesburg, which has been endeavoring to obtain a Commission Order approving rate recovery since April 1987, has done nothing to waive entitlement to these rates. The rates requested by Milesburg are rates calculated under West Penn's methodology, which (1) results in lower rates than the methodology in the Commisison's regulations and (2) is the appropriate methodology for determining avoided costs in this proceeding, as per the agreement of the parties and the ALJ recommendation. It therefore follows that if Milesburg is entitled to, for example, 6¢/kwh under the regulations, it is entitled to a *lesser* amount under West Penn's methodology. The fact that Milesburg has not attempted to invoke the capacity credit methodology in the Commission's regulations means that ratepayers will pay *less* for Milesburg power than would otherwise be required. Rather than require Milesburg to initiate a separate proceeding to seek *higher* rates, as the ALJ recommended, the Commission should require West Penn to execute a new contract with Milesburg, identical in most respects to the lapsed 1987 contract, with the financing date set six months after the receipt of a final and nonappealable Commission Order, with similar extensions to related milestones. It simply does not make sense to hold that Milesburg must initiate a new proceeding to seek rates

higher than the rates it has requested. Moreover, Milesburg already has been before the Commission and Commonwealth Court for 2½ years. In my opinion, requiring Milesburg to start over with a separate evidentiary proceeding likely would result in the abandonment of the Milesburg Project.

With respect to the rate determination, it is my opinion, first, that West Penn's methodology should be utilized, as modified by the additional calculation reflecting monthly, as opposed to annual, payments discussed above. This conforms with the ALJ's R.D. in Phase One at pp. 97-100. Very simply, West Penn "fine-tuned" its methodology between execution of the Milesburg contract and the other three contracts at issue in this proceeding. This refinement should be incorporated because the Commission would be ordering the execution of a *new* contract if this motion is adopted. Therefore, the newer format should be utilized. This refinement has the effect of lowering the rates paid to Milesburg.

Second, the "in-service date" of Milesburg (an input into West Penn's methodology) should be moved forward to 30 months after the receipt of a final, nonappealable Commission Order in this proceeding. Because we do not know if our Order will be appealed, or how long it will take to resolve any appeals that are filed, the particular capacity credit cannot be determined precisely at this time. However, *when* the projected in-service date is known, calculating the resulting credit is simply a mathematical exercise using West Penn's methodology.

This recommendation has the effect of increasing Milesburg's capacity credit because West Penn's methodology places a higher value on capacity that more closely matches West Penn's need for capacity in 1995. This is the reason, for example, that Shannopin's capacity credit of 4.0¢/kwh is higher than the other capacity credits at issue in this proceeding. The 30-month period after a final nonappealable Order is recommended (for estab-

lishing an in-service date) by deducting the six-month extension agreed upon by all parties to the Consent Order of September 1, 1988 from the estimated financing and construction period of 36 months.[1] Although the ALJ concluded that the Consent Order barred any increase to the capacity credit, in my opinion the Consent Order was intended merely to deny any increase based on the six-month extension that was agreed upon. In other words, a reasonable interpretation of the Consent Order is that the *quid pro quo* for getting parties to agree to the limited six-month extension was Milesburg's agreement not to seek a capacity credit increase based on that particular six months.

In my opinion, it is essential that the Commission recognize and reflect regulatory delay in its Order. Project financing is very time sensitive because a project's capital costs are constantly increasing as time goes by. If a project is stuck with fixed rates as its costs go up, the project's internal rate of return will decline to the point that the project cannot be financed. Should the Commission fail to make adjustments for time delays, the Milesburg project likely will be abandoned. Perhaps more importantly, the Commission will be inviting interventions in opposition to future rate recovery proceedings because intervenors will know that they can win by default regardless of the merits of their position. In essence, intervenors will be able to kill future QF projects simply by filing answers in opposition to rate recovery petitions and taking the projects into a lengthy hearing and appellate process. This will be the exact result of the instant proceeding with respect to Milesburg if the Commission fails to make adjustments for regulatory delay, despite the clear findings of the ALJ (and presumably the Commis-

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[1] Milesburg estimated that construction would take 30-36 months; adding six months for financing to the lowest estimate for construction of 30 months equals 36 months.

sion) that the project is beneficial to ratepayers and to Pennsylvania and the equities are on the side of the QF.

Additionally, although the nominal capacity rate will increase, the rates in real terms will not increase as much due to the time value of the money and the delayed in-service dates. Secondly, the resulting capacity credit is merely the capacity credit that would have resulted from an application of West Penn's methodology *if* the parties could have anticipated the delayed in-service date resulting from the extensive litigation in this proceeding. West Penn's methodology is a conservative methodology for calculating avoided costs; hence the capacity credits calculated by the methodology likewise are low. Therefore, even with an adjustment to the in-service date, obtaining firm baseload capacity at a fixed rate of, for example, 5¢/kwh is a bargain compared to rates that would be paid for utility-built capacity.

For all of the foregoing reasons, the ALJ's recommendation regarding Milesburg in Phase Two of this case should be reversed.

B. *Burgettstown*

North Branch's April 5, 1989 Section 508 Petition similarly requests modification of milestone dates and increased capacity rates to reflect the delay in the in-service date for the Burgettstown Project. North Branch filed an Application for Stay on August 21, 1989 which was the subject of a 2-2 (no action) vote at the Public Meeting of August 31, 1989. On September 8, 1989, North Branch filed a Motion for Reconsideration and Amendment to its Exceptions to the ALJ's R.D. The Amendment withdraws North Branch's request for an increase to the capacity credit. Therefore, the Phase Two issues remaining before the Commission are:

1. The request to modify milestone dates set forth in the April 5 Section 508 petition.

2. The August 21 Application for Stay.

3. The September 8 Motion for Reconsideration.

The latter two issues, of course, post dated and therefore were not ruled upon by the ALJ's R.D.

For the reasons set forth in the previous discussion of Milesburg's Phase Two issues, I suggest that (1) the milestones be extended under Section 508; and (2) the Application for Stay of the financing closing date be granted. To do anything but to grant the stay and order the milestone extensions would make no sense, unless the Commission had decided to change its policy of encouraging the development of cogeneration and small power production. As North Branch states in its Motion for Reconsideration, failure to stay the financing closing date will result in automatic termination of its contract without any consideration of the merits, merely because of the length of time it has taken to complete this proceeding.

THEREFORE, I MOVE: That the Commission adopt an Opinion and Order consistent with all of the foregoing, modifying the Administrative Law Judge, Larry Gessoff's Recommended Decision regarding Phase I issues as discussed above and reverse the ALJ's Recommended Decision on Phase II issues, thereby granting extensions to Milestone dates for the Milesburg and Burgettstown Project and increasing the capacity rate for the Milesburg Project.

/s/ Bill Shane
BILL SHANE
Chairman

DATED: 9/20/89

Public Meeting of September 21, 1989

STATEMENT OF COMMISSIONER FRANK FISCHL

RE: WEST PENN POWER COMPANY PETITIONS
P-870216, P-880283, P-880284, P-880286
AUG-89-ALJ-124

I AM OPPOSED TO THE MOTION BECAUSE IT IS DETRIMENTAL TO WEST PENN RATEPAYERS AND IN SOME CASES BEYOND THE AUTHORITY OF THIS COMMISSION.

THE CAPACITY CREDITS REQUESTED ARE CLEARLY ABOVE WEST PENN POWERS' AVOIDED COSTS.

AS TO THE CONTRACT ISSUES, OUR REGULATIONS CLEARLY STATE NONINTERFERENCE WITH FREELY NEGOTIATED CONTRACTS. THE ALJ CORRECTLY CONCLUDED THAT IF THE DEVELOPERS ARE PERMITTED TO MODIFY THE NEGOTIATED ELECTRIC ENERGY PURCHASE AGREEMENTS BECAUSE OF UNFORESEEN EVENTS, THE CONTRACTS BECOME MEANINGLESS.

I; THEREFORE, VOTE *NO*.

September 21, 1989
DATE

/s/ Frank Fischl
FRANK FISCHL
Commissioner

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, Pa. 17120

Public Meeting September 21, 1989

Docket No. P-879210, P-880283, P-880284, P-880286
ALJ—124

PETITION OF WEST PENN POWER COMPANY FOR
APPROVAL OF EEPA FOR MILESBURG *et al.*

STATEMENT OF COMMISSIONER
JOSEPH RHODES, JR.

Mr. Chairman, I intend to support your motion for the resolution of the EEPA's of West Penn Power that are before us today, though I do so with considerable reluctance. In essence we are abrogating bona fide contracts that were willingly entered into by all parties. As anyone who has negotiated a contract would attest: a closing date is a crucial negotiated element of any contract. Time is money; and even more so when we are talking about electric utilities with long lead times associated with constructing generating facilities. What your motion does is to increase the certainty associated with PURPA projects for the developer and to decrease it for utilities.

What persuades me to support your motion is that the delays associated with these projects stem from extended litigation before Commonwealth Court and this Commission. I would, however, consider this action today to be the exception not the rule. "Once burned, shame on you; twice burned shame on me."

It would seem prudent that current and future QF project negotiations should anticipate the possibility that protracted litigation will delay the closing date for the project. Contracts should be sufficiently robust to take this into account. Of course, there is no free lunch. What I'm talking about is a kind of insurance with a schedule of power costs that reflect the slippage of time. Utilities should not have to provide this for free.

If such contingency provisions are not part of a QF contract and the closing date slides for any reason, this Commissioner will assume that the parties declined to take out the insurance policy and just got burned.

9-21-89
Date

/s/ Joseph Rhodes, Jr.
JOSEPH RHODES, JR.
Commissioner

APPENDIX N

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held September 21, 1989

Commissioners Present: Bill Shane, Chairman
William H. Smith,
Vice Chairman
Joseph Rhodes, Jr.
Frank Fischl, dissenting

Docket Nos.
P-870216
P-880283
P-880284
P-880286

PETITIONS OF WEST PENN POWER COMPANY FOR APPROVAL OF ELECTRIC ENERGY PURCHASE AGREEMENTS AND FOR ORDERS GRANTING RATE RECOGNITION OF PURCHASE POWER COSTS

Re: MILESBURG ENERGY, INC.
MONONGAHELA LOCK & DAM NO. 8
BURGETTSTOWN PROJECT
SHANNOPIN MINE PROJECT

ORDER

BY THE COMMISSION:

Before us for consideration is the Recommended Decision ("R.D.") of Administrative Law Judge Larry Gesoff ("ALJ") issued June 27, 1989 in the above-

captioned consolidated proceedings, as well as the Exceptions and the Reply Exceptions filed by the various parties. Also before us is the Application for Stay of Proceedings and Motion for Reconsideration filed by North Branch Energy Partners, L.P. ("North Branch") on August 21, 1989 and September 12, 1989, respectively, at Docket No. P-880284, as well as various responsive pleadings thereto. For the reasons stated more fully below, we will (1) grant West Penn Power Company's ("West Penn") petition at Docket No. P-880283 for approval of the Electric Energy Purchase Agreement ("EEPA") with Noah Corp., the developer of the Monongahela Lock & Dam No. 8 Project; (2) grant West Penn's petition at Docket No. P-880286 for approval of the EEPA with Mon Valley Energy Corp. ("Mon Valley"), the developer of the Shannopin Mine Project; (3) grant West Penn's petition at Docket No. P-880284 for approval of the EEPA with North Branch, the developer of the Burgettstown Project, while granting North Branch's Petition for Modification and Application for Stay with respect to the Financing Closing Date and related milestones in its EEPA; and (4) require West Penn to execute a new EEPA with Milesburg Energy, Inc. ("Milesburg"), similar in terms and conditions to Milesburg's 1987 EEPA but with modifications to the Financing Closing Date and related milestones and revisions to the capacity credit, grant approval of the revised EEPA, and deny West Penn's petition to withdraw its rate recovery petition. With respect to the rate structure issue raised in this proceeding, we find merit in the concept of allocating capacity charges to customers on a demand/energy basis through West Penn's Energy Cost Rate ("ECR") mechanism. However, rather than requiring West Penn to modify its ECR in its next annual filing, we will open a separate proceeding to consider modifications to West Penn's ECR after receipt of an advisory report from our Bureau of Audits.

BACKGROUND

The long history of these proceedings was fully described at pp. 1-32 of the ALJ's R.D., which we will incorporate by reference herein.

Following issuance of the ALJ's R.D. on June 27, 1989, Exceptions were filed by Milesburg, North Branch, the Office of Consumer Advocate ("OCA"), and Armco Advanced Materials Corp./Allegheny Ludlum Corp. ("Armco/Allegheny"). The West Penn Power Industrial Intervenor's ("WPPII")[1] filed a letter stating that it did not intend to file Exceptions to the ALJ's R.D. Reply Exceptions were filed by West Penn, OCA, WPPII, Armco/Allegheny and jointly by North Branch, Milesburg, and Mon Valley.

On August 21, 1989 North Branch filed an Application for Stay of Proceedings with respect to the Financing Closing Date of October 1, 1989 in its EEPA. West Penn filed an Answer and Armco/Allegheny filed a Protest opposing North Branch's Application on August 25 and August 28, respectively. On September 12, 1989 North Branch filed an Amendment to its Exceptions, thereby withdrawing its request for modification to its capacity rates, and a Motion for Reconsideration. Answers to the Motion for Reconsideration were filed by West Penn and Armco/Allegheny on September 15 and September 13, respectively. North Branch filed a Response to West Penn's Answer on September 19, 1989.

Our decision of today's date addresses the merits of the issues raised in these consolidating proceedings and grants North Branch's Application for Stay.

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[1] WPPII is an ad hoc group of industrial customers comprised, in these proceedings, of Airco Industrial Gases, Latrobe Steel Co., National Roll Co., Pennsylvania Pressed Metals, Powder Metal Products, Inc., and PPG Industries, Inc.

DISCUSSION

We will address the issues raised in this proceeding seriatim by reference to the ALJ's R.D. regarding each issue, which we incorporate by reference herein, and the Exceptions and Rely Exceptions thereto. A discussion and ruling on the North Branch Application for Stay will follow. Phase I of the proceeding generally addresses the reasonableness of the capacity credits set forth in the various EEPAs as well as the rate structure issue regarding the methodology by which the capacity costs paid by West Penn to developers of qualifying facilities ("QFs") should be recovered from ratepayers. Phase II of the proceeding addresses issues raised by the lengthy delay in the approval process to which the EEPAs have been subjected.

A. PHASE I.

1. *The Legal Standard to be Applied; R.D. 32-42.*

The ALJ rejected the arguments of Armco/Allegheny and OCA that the Commission's regulations cannot be used as a benchmark to assess the reasonableness of capacity rates in negotiated contracts. Rather, the ALJ concluded that, if negotiated rates are at or below the rates to which a QF would be entitled as a matter of law (i.e., as defined by the Commission's regulations), the rates are *per se* reasonable. The ALJ rejected the collateral attack by Armco/Allegheny and OCA on the Commission's regulations, stating that they are in full force and effect unless and until they are modified by the Commission or invalidated by the Commonwealth Court. Nevertheless, the ALJ concluded that, due to the nature of the evidence in this record, in these proceedings the reasonableness of the various capacity credits should be measured against West Penn's methodology as opposed to the Commission's regulations.

Milesburg excepts to the ALJ's conclusion that, due to the evidence in this record, the Commission's regulations

cannot be used as the benchmark in these proceedings. Milesburg states that West Penn's witness introduced the calculations under the regulations into the record on behalf of the parties to this proceeding, and that whether West Penn or other parties are critical of the regulations is irrelevant. Milesburg notes that the Commission consistently has held that its regulations should serve as the standard against which the reasonableness of rates in an EEPA are to be evaluated.

North Branch excepts to this portion of the ALJ's R.D. as well, noting that West Penn's witness stated on the record that West Penn's avoided cost filing of July 31, 1986, which reflected a capacity credit for 1991 of 4.85 cents per kwh, represented West Penn's best estimate of its avoided costs based on its interpretation of the regulations. North Branch states that the ALJ erred in disregarding the calculations based on West Penn's opposition to and collateral attack of the regulations.

OCA excepts to the portion of the R.D. that states that calculations under the Commission's regulations could serve as a proper benchmark against which the reasonableness of the capacity credits could be measured based on OCA's argument that the Commission's regulations do not employ discounting and therefore violate Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S. § 824a-3 ("PURPA 210").

West Penn's Reply Exceptions at p. 2 state that "[n]o party has challenged the formulas developed by [West Penn] for computing avoided cost, which produce a lower avoided cost figure than under the Commission's own regulations, but rather only the inputs used in the formulas." West Penn states that it is not necessary in this case to choose between West Penn's and the Commission's methodologies because, except for a minor adjustment to the Milesburg calculation, use of either methodology results in approval of the contract rates as being at or below avoided costs.

North Branch, Milesburg and Mon Valley, jointly filed Reply Exceptions ("Projects' Reply Exceptions") stating that OCA's criticism of the Commission's regulations should be given no consideration in these proceedings.

OCA's Reply Exceptions state, *inter alia*, that the ALJ's recommendation not to apply the Commission's regulations was not based on West Penn's criticisms, but on the lack of an adequate evidentiary foundation for their consideration. OCA states that the Projects had an opportunity to file answering testimony and alternate calculations. OCA argues that the testimony of West Penn witness Kave and West Penn's 1986 avoided cost filing were not sufficient evidence.

Armco/Allegheny's Reply Exceptions state that, since the R.D. assessed the various capacity credits based on West Penn's methodology, it makes no difference that the R.D. did not compare the capacity credits to rates derived under the Commission's regulations. Armco/Allegheny argue that the regulations are ambiguous and produce rates in excess of avoided costs; that West Penn's avoided cost filings apply only to QFs of 500 kw or less; and that the QFs in this proceeding are not automatically entitled to capacity rates set forth in annual avoided cost filings.

On this issue, we adopt the ALJ's recommendation. The reasonableness of rates in negotiated contracts generally is to be determined by a comparison to rates that would be required by an application of the Commission's regulations. This is a fundamental concept that has been the basis for nearly all of the Commission's Orders approving rate recovery of amounts to be paid to QFs under negotiated agreements. The methodology in the Commission's regulations is binding upon all in Pennsylvania unless and until the Commission revises it as a result of the generic investigation at Docket No. I-860025 or otherwise. We find no merit in arguments that our regulations overstate a utility's avoided costs. State regulatory com-

missions have been granted a substantial degree of latitude in the implementation of PURPA 210, and avoided costs are *defined* by our regulations. In other words, our regulations determine what a utility's avoided costs are under the law, notwithstanding arguments that a different methodology or methodologies might be preferable. The possibility that our regulations may not be perfect in some party's view is irrelevant. The regulations were finalized in January 1983 after an extended notice and comment period in a proceeding where all interested parties had the opportunity to make their views known. Although we may refine our regulations as a result of our generic investigation, in our view the regulations are basically sound. In particular, our coal proxy regulation at 52 Pa. Code § 57.34(c) recognizes the fact that logically the next base load unit for a utility in Pennsylvania that is anticipating a need for additional base load capacity would be a coal plant. By basing capacity credits on a capital-intensive unit with relatively stable associated energy credits, the coal proxy regulation encourages the development of capital-intensive qualifying facilities such as those that are fueled by coal or coal waste. From both a ratepayer and a public policy perspective, in our view it is important that our regulations under PURPA 210 permit continued development of coal and coal waste facilities.

Nothwithstanding the fact that generally avoided costs are to be determined by application of our regulations, we agree with West Penn that it is not necessary in this proceeding to choose between West Penn's and the Commission's methodologies because use of either methodology results in approval of the contract rates. All parties agree that West Penn's methodology produces rates that are lower than rates produced by the Commission's regulations. None of the Projects have requested rates calculated under the regulations. Therefore, as a practical matter, we adopt the ALJ's recommendation to utilize West Penn's methodology as the benchmark for determin-

ing West Penn's avoided costs in these proceedings. Since rates calculated under our regulations would be *per se* reasonable, and West Penn's methodology produces lower rates, it follows that rates calculated under West Penn's methodology (assuming the inputs are appropriate) are *per se* reasonable as well. Our decision on this issue also renders it unnecessary to resolve any ambiguities that may exist in our regulations at this time.

2. *Burden of Proof, R.D. at 42-44.*

The ALJ concluded that under Section 332(a) of the Public Utility Code, 66 Pa. C.S. § 332(a), West Penn has the burden of proof in these proceedings as the proponent of an Order. The ALJ states that West Penn must meet its burden of proof by substantial evidence. No party filed an exception to this conclusion. We adopt the ALJ's recommendation on this issue.

3. *Time Frame, R.D. at 44-52.*

With respect to the time frame that will be utilized to determine West Penn's avoided costs, the ALJ recommended adoption of West Penn's agreement in principal on rates as the time of serious negotiations under the Commission's standard set forth in *Pennsylvania Public Utility Commission v. Duquesne Light Company,* Docket No. R-860556 (July —, 1987). Agreement in principle on rates was reached in April 1985, May 1986, September 1986, and October 1986 for the Monongahela, Milesburg, Shannopin and Burgettstown Projects, respectively.

The only party to file an exception to this recommendation was Armco/Allegheny, which argue that the date that the EEPAs were executed should be utilized. Armco/Allegheny state that two tax changes occurred prior to the contract signing dates that should be incorporated into the calculation of the capacity credits for the Milesburg, Shannopin and Burgettstown Projects, namely the Tax Reform Act of 1986, signed into law October 22, 1986

and effective in tax years 1987 and beyond, and a reduction in the Pennsylvania Corporate Net Income Tax effective January 1, 1987. Armco/Allegheny argue that the dates of contract execution (February 25, 1987 and October 15, 1987) are the earliest dates that the serious negotiations standard should be deemed satisfied because these were the dates the Projects were legally committed.

West Penn's Reply Exceptions state that the issue is whether West Penn's use of time of agreement in principle to determine avoided costs was reasonable. West Penn notes that Armco/Allegheny offered no witness with experience in negotiating QF contracts or with experience in financing such contracts; witnesses with such experience were West Penn's chief contract negotiator; representative of the Projects, and a Vice-President of Mellon Bank with considerable experience in project financing. West Penn states that the testimony of these witnesses demonstrates that calculation of avoided costs at the time of agreement in principle on rates is critical to encourage and stabilize the process of voluntary negotiation of contracts under PURPA, since the developer of a QF needs rates upon which it can rely in evaluating the potential feasibility of a project. Typically, a developer has only limited available resources and has to borrow between 75% and 85%, and sometimes more, of the funds necessary to construct a facility. Usually this money is loaned without recourse to any assets other than the project itself; therefore, lending institutions must rely on the revenue stream generated by the sales of power to repay the debt. As a result, substantive evaluation of project financing cannot be made until the qualifying facility and the utility have agreed upon a particular rate. An up-front evaluation of economic feasibility is important because often the substantial investment to lay the groundwork for a project is not possible without some assurance that the project is economically feasible. If West Penn were not able to agree to purchase rates until a contract is

signed, the QF could get all the way to final contract negotiations only to find the avoided costs for capacity have dropped. West Penn states that, although a broad "serious negotiation" standard creates problems for a utility, West Penn's selection of a specific point during negotiations (agreement in principle) is consistent with the intent of the serious negotiation standard. In calculating avoided costs for these contracts, West Penn selected a specific time during the negotiation process at which its risk of relying on a project's capacity for planning purposes is significantly reduced. West Penn states that Armo/Allegheny's argument on this point applies hindsight because, in this case, lower rates would result. However, avoided costs just as easily could have increased.

The Projects' Reply Exceptions state that Armco/Allegheny's position on the tax issue in reality is a request that the Commission change its policy on the serious negotiations standard, and that any changes in policy should not be made retroactively. Acceptance of Armco/Allegheny's argument would assume that existing policy is meant to be changed on a case-by-case basis and would seriously undermine the Commission's credibility. The Projects support the Commission's standard because it ensures that negotiated rates will be preserved as negotiations continue; under Armco/Allegheny's proposal developers would be required to petition the Commission for higher rates under the regulations in order to "lock-in" avoided cost estimates. The Projects note that Armco/Allegheny relied solely on the testimony of one witness to support their argument who had no experience in advising parties to QF contracts, had never negotiated a QF contract, and did not consider the effect of his theory on potential developers. Nevertheless, with no experience or background, the witness stated that "[t]he time frame of serious negotiations is completely nebulous and ambiguous. Such a time frame could expanse years of negotiations prior to the signing of a contract." Projects' Reply Exceptions, p. 3. The Projects assert the time frame for

serious negotiations is neither nebulous nor ambiguous, and that each project has identified a specific period, none longer than seven months, during which rates were agreed upon and expenditures were made in reliance thereon. The Projects state that Armco/Allegheny's witness has confused negotiation of rates with negotiation of technical terms and conditions. The Projects refer to testimony that, without a firm commitment on price (1) contractors and engineers are reluctant to provide bids and financing is unavailable; (2) developers would not risk the substantial development costs required to perform essential activities necessary to advance a project from the early feasibility study stage to contract signing; and (3) use of contract execution date would have a chilling effect on cogeneration and small power production. The Projects state that use of hindsight would establish a constantly moving target with respect to avoided capacity rates and could be used by a utility to circumvent the requirement to provide capacity credits to a QF merely by refusing to enter into an EEPA or by delaying execution of an EEPA. The Projects argue that the rates quoted to the Projects were reasonable at the time, and any change thereto would be retroactive policy-making which has never been contemplated by this Commission even in the generic investigation. Finally, the Projects' Reply Exceptions briefly describe the negotiations and project development work that took place for each Project and conclude that each Project satisfied the serious negotiations standard in *Duquesne*. The Projects aver that Armco/Allegheny's proposal is totally unrealstic and cannot result in a negotiated EEPA because an EEPA cannot be executed without the prior completion of substantial development work. With respect to the related tax issue, the Projects state that West Penn correctly applied the tax laws in effect at the time of serious negotiations in the calculation of the Fixed Charge Rate ("FCR"). The Projects' rates were calculated in or before May 1986 while the Conference Report on the Tax Reform Act of

1986 was not issued until September 19, 1986. Thus, it is unreasonable to argue that West Penn should have recalculated its prior firm price quotes after the Projects had expended substantial amounts of money in reliance upon those rates.

On this issue we adopt the ALJ's recommendation, and reiterate our longstanding policy that avoided costs are to be determined as of the time of serious negotiations. Objective criteria are needed and must be applied consistently to give reliability to negotiations between utilities and QFs. Otherwise, avoided cost rates would evolve into a constantly moving target, a phenomenon that would undermine contract negotiations and chill the continued development of cogeneration and small power production facilities. Our policy was formulated in recognition of the fact that a utility's avoided costs could drop; however, a utility's avoided costs just as easily could rise. The ALJ correctly noted that, "[u]ltimately, no matter what time is used to fix EEPA purchase rates, the ratepayers bear a risk that avoided costs will go down after that time and the QF bears the risk that avoided costs will go up." R.D. at 51. For the reasons set forth in the Reply Exceptions of West Penn and the Projects, we find that Armco/Allegheny's argument that time of contract execution should control is without merit. Therefore, we affirm our policy on the serious negotiations standard and accept West Penn's agreement in principle on rates as the time that the serious negotiations standard was satisfied. Our adoption of the agreement in principle on rates is limited to the facts of the instant proceeding since utilities other than West Penn utilize different practices and procedures when negotiating QF contracts. Moreover, if the evidence in a proceeding demonstrated that a utility unreasonably delayed the issuance of project price proposals, the time frame for serious negotiations would be set prior to the agreement in principle on rates. In addition to the need to prevent avoided costs from evolving into a moving target,

there is a need to assure that utilities cannot deprive QFs of avoided cost rate entitlement by delaying negotiations.

4. *The Reasonableness of the Capacity Rates in the EEPAs.*

a. *West Penn's Methodology, R.D. at 52-55.*

The ALJ's description of West Penn's methodology is not a recommendation on a contested issue, and does not require a discussion. Nevertheless, the ALJ's R.D. aptly summarizes West Penn's methodology and the remaining issues in Phase I of these proceedings. Therefore, for purposes of clarity and completeness, we will set forth in full this section of the R.D.

West Penn's methodology for calculating the avoided costs in the EEPAs is set forth in WPP Exhibit 1 and described in WPP Statement 1 at pages 15-20 generally and at pages 20-24 for each Project. West Penn's methodology is included in a report captioned "The Value of Generating Capacity". WPP Ex. 1. West Penn's methodology calculates avoided costs by determining the amount of overlap between the QF's supply of capacity and the APS need for capacity. This overlap shows how much capacity (in months) can be avoided by recognizing the in-service date and economic life of the APS plant as well as the in-service date and contract term of the QF. These avoided costs are spread over the QF contract term as a levelized rate such that the present value of the avoided APS plant costs equals the present value of the payments to the QF. According to Mr. Kave, these equivalent present values ensure that the ratepayers pay no more for QF capacity than the avoided costs of the APS plant, regardless of the in-service date and contract term of the QF. WPP St. 1 at 15-16.

The APS need for generating capacity is determined from the APS Integrated Resource Plan which, for these Projects, shows that new, avoidable generating capacity

would be needed in the form of three, 300 Mw coal-fired units. These units were included as a part of West Penn's annual system cost data filing (52 Pa. Code § 57.33) and the annual resource planning report (52 Pa. Code § 57.49). Mr. Kave states that these units are also consistent with the coal proxy definitions used within the Commission's regulations. WPP St. 1 at 16.

The rates in cents per Kwh will differ among projects depending on the length of the contract term and the QF's in-service date. Generally, the closer a QF's in-service date is to WPP's need for capacity, and the longer the contract term overlaps the life of the avoided plant, the greater the costs are that can be avoided.

Similarly, avoided capacity rates differ depending on when the next APS plant is needed. That is, for a given QF contract term and in-service date, the rate may change if the APS Integrated Resource Plan changes. All other things being equal, the farther into the future the next need for an APS plant, the lower the avoided capacity cost rates will be under APS's methodology. This tends to discourage capacity additions by QFs that are not needed. Conversely, if there is a near term need for capacity, the methodology tends to encourage QF development by offering higher rates. According to Mr. Kave, this sensitivity to forces of supply and demand creates a built-in safeguard against excess capacity problebs. WPP St. 1 at 17.

Another reason that capacity rates may differ among projects is that capacity rate calculations are performed using standard APS information and estimates which are available at the time of calculation. Since these calculations are performed at different times, the underlyling information may change. WPP St. 1 at 17.

Capacity rates are normally paid to QFs on a cents per Kwh basis for Kwh's of energy which are scheduled and delivered. This provides a strong incentive for the QF to maximize its availability and deliveries. Under

dispatch conditions the QF is paid a capacity rate for the amount of capacity which is available and scheduled for possible delivery. Under certain conditions of poor performance, such as excessive deliveries during off-peak hours and inability to meet dispatch criteria, the capacity payments to the QF are reduced. WPP St. 1 at 17.

As noted above, West Penn maintains that the EEPA rates are below its avoided costs under either its methodology or the Commission's regulations. No party challenged West Penn's methodology or the calculated energy rate in the EEPAs.

At issue are the correctness of the inputs West Penn used in its methodology regarding the capacity rate calculation. These inputs include the reserve margin, the type of avoided unit used (coal v. combustion turbine), the avoided unit's availability, and the fixed charge rate.

Also at issue is WPPII's assertion that West Penn's capacity rates should be based on the renovated Springdale and Mitchell plants which will come on line before any of the QFs. In addition, OCA argues in favor of a correction to the Milesburg Project avoided capacity costs to reflect monthly payments required by the EEPA. Finally, Armco/Allegheny and WPPII argue for EEPA capacity rates to be passed through to West Penn's ratepayers on a demand/energy basis instead of on an energy basis only. These issues are addressed below.

b. *Reserve Margin, R.D. at 55-71.*

The ALJ recommended adoption of West Penn's planning reserve margin of 25%. Armco/Allegheny and OCA argued for reserve margins of 15% and 20%, respectively. The ALJ's R.D. accurately summarizes the position of each party and is, as stated above, fully incorporated herein by reference. The ALJ concluded that West Penn demonstrated that its planning reserve margin was not out of line with the electric industry throughout the United States and within the North American Reliability Coun-

cil's ("NERC") regional council; that West Penn's high load factors and number of super-critical generating units supported its 25% margin; that West Penn used correct judgment in 1986 that the planning reserve margin should not be changed in response to a then recent improvement in generation availability; and that West Penn used correct judgment in considering potential acid rain legislation as one of several reasons why current availability data might not hold in the future. The ALJ concluded by noting that forecasting a reserve margain requires the use of studies and computer analyses, but the final decision requires informed judgment based on experience. The ALJ found that West Penn demonstrated that its 25% reserve margin decision was supported by studies available when the decision was made and by informed judgment based on experience, and recommended approval of the 25% planning reserve margin.

OCA and Armco/Allegheny excepted to the recommendation. OCA reiterates its claim that Allegheny Power Systems ("APS"), West Penn's parent company, should have conducted new reserve margin and generation planning studies in 1986, which would have indicated that the planning reserve margin should have been no more than 20% based primarily on an increase in unit availability on the APS system between 1983 and 1986 and OCA's view that large interconnected systems generally have a reserve margin of 15% to 20%. Armco/Allegheny reiterate their claim that West Penn did not meet its burden of proof with respect to its 25% planning reserve margin because the studies relied upon by West Penn were outdated and because West Penn and APS have allowed their reserve margins to drop below 25% by entering into agreements for the sale of 700 MW to out-of-state utilities.

West Penn's Reply Exceptions state that the issue is not, as OCA and Armco/Allegheny would like frame it, whether APS should have done a formal study in 1986 but whether, in light of the objective information avail-

able to APS planners in 1986, the judgment to use a 25% planning reserve margin in calculating avoided costs for these contracts was reasonable. West Penn states that the ALJ correctly concluded that its judgment regarding the proper planning reserve margin was appropriate given, *inter alia*, the existence of the super-critical units on the APS system, APS' high load factor, and the availability of the units. With respect to Armco/Allegheny's exception, West Penn states that the 700 MW off-system sale in the winter of 1988/89 has no bearing on APS' planning reserve margin because the sale is interruptible and subordinate to native system load, which permits APS to use its existing capacity effectively without compromising system reliability. APS does not plan for off-system sales when determining that new capacity is needed; therefore the projected addition of capacity in 1995 was planned to meet native load plus a 25% reserve margin, as opposed to native load, plus off-system sales, plus 25%. West Penn notes that the 700 MW off-system sale actually was a sale of 700 MW for one year dropping to 300 MW for six years and zero thereafter.

The Projects' Reply Exceptions emphasize that West Penn's 25% planning reserve margin had been sanctioned by the Commission in two prior proceedings, that the reserve margin is being used for planning purposes by West Penn to this day, and that West Penn still projects a need for energy in 1995. The Projects state that the reasonableness of West Penn's planning reserve margin is the issue, not the exact results of West Penn's forecasts.

Upon review of the Exceptions and Reply Exceptions we find nothing that was not considered by the ALJ prior to making his recommendation that West Penn's planning reserve margin of 25% be adopted. The ALJ's decision on this issue is persuasive and we adopt it as our own. We find particularly persuasive the rebuttal testimony of West Penn's Director of Planning regarding the factors

that were taken into account in establishing the reserve criterion, particularly the existence of ten super-critical units ranging in size from 540 mw to 640 mw, each of which is about 10% of the APS system peak load; APS' high load factor, which is normally one of the ten highest load factors of the top 100 investor-owned utilities in the country; and the uncertainty whether the recer' improvement in unit availability would continue given, *inter alia*, the fact that the equipment is aging and the temporary lower stress levels on individual units resulting from temporarily higher operating reserves. One issue raised on exception that was not addressed by the R.D. was Armco/Allegheny's argument that the *interruptible* off-system sale of 700 MW in 1988/89 (dropping to 300 MW for six years) demonstrated that West Penn did not need additional capacity. We find this completely unpersuasive for the reasons set forth in West Penn's Reply Exceptions.

c. *Coal Unit v. Combustion Turbine, R.D. at 71-80.*

The capacity credits in this proceeding were based on West Penn's projection in 1986 that the next generating unit it would construct would be a series of three 300 MW coal units, the first of which would be brought on line in 1995. OCA argued that in 1986 West Penn should have planned to construct oil or gas fired combustion turbines ("CTs") to provide peaking capacity before constructing additional coal units. The ALJ concluded that West Penn submitted substantial evidence to support the APS decision in 1986 that a coal unit would be required in 1995.

OCA excepted to this finding, arguing that peaking units (oil or gas fired CTs) should have been planned by West Penn rather than base load generation in the form of coal fired units. OCA's preference for oil or gas fired units is based on arguments pertaining to need for fuel

diversity, projected fuel costs for the coal plant v. marginal fuel costs on the system, and the use of a dependent forced outage rather than actual unit unavailability in West Penn's studies.

West Penn's Reply Exceptions state that the APS 1986 Generation Plan was supported by considered judgment based on the following factors:

(1) the many years of satisfactory service provided by coal-fired units to APS and its ratepayers;

(2) the drastic escalation in the price of oil and gas even though tempered by a drop in prices in late 1985 and early 1986;

(3) the results of studies that at best showed only a minor financial advantage for combustion turbines;

(4) the technological limitation(s) on combustion turbines at that time; and

(5) public policies and laws designed to encourage the use of coal.

West Penn's Reply Exceptions refer to its Main Brief and Reply Brief, which refute the arguments in support of an oil or gas fired peaking unit raised by OCA. With respect to fuel diversity, West Penn states that the objective is not to provide a pre-determined fuel mix, but to provide a reliable power supply at the lowest cost, which should be done by using the fuel sources that are the most reliable and cost the least over the planning horizon. West Penn notes that the APS service area has large reserves of coal that have over time provided a stable supply of fuel at a reasonable cost; that the availability and price of oil and gas have been unpredictable and uncertain; and that the economy of the APS service area benefits from the use of coal.

With respect to OCA's argument comparing fuel costs of a coal plant to the fuel costs of the APS system, West

Penn states that even if the new coal units were projected to have a higher operating cost than the average costs on the system, it is inappropriate to compare operating costs between types of generation. West Penn notes that if this type of comparison were to be made, CTs always would have exceedingly high costs (about 4¢ to 10¢/kwh depending on oil and gas prices) compared to coal. West Penn states that neither of the computer runs discussed by OCA shows either a large benefit or cost to installing CTs, and that there certainly was not enough difference to make a decision based *only* on computer runs. West Penn avers that "[t]he decision to stay with coal fired generation was based on the experience of many years and common sense. *The use of coal has been the reason the APS cost of electricity has been among the lowest in the country.*" West Penn Reply Brief at 12 (emphasis supplied).

With respect to OCA's argument on the use of dependent forced outage rates, West Penn states that the purpose of using these rates is to better model the way the power system actually operates. While most computer models use an average forced outage rate, in actual practice many units may be out of service at one time, necessitating the use of CTs. West Penn states that if there are many units out of service at the same time, usually it is due to some type of dependency, i.e., weather-related, equipment similarities, storms, etc. When these dependent forced outage conditions do occur, necessitating the use of CTs, it might be necessary to run them eight to thirteen hours a day because of the APS high daily load factors, where hourly loads do not vary much over long periods during the day.

The Projects' Reply Exceptions state that OCA's entire argument that the avoided unit should have been a CT rather than a coal-fired unit is that planning and judgment cannot be used along with a least cost study. The Projects state that, while all of West Penn's planning

for the mid-1990's included adding base load plant in 1995, OCA unilaterally decided that West Penn should add peaking power in that year and assumed a low cost and available source of oil in 1995 and beyond. The Projects state that none of OCA's assumptions as to oil prices were known in early 1986, and that OCA's continued reliance on its argument with respect to cheap and stable oil prices in the future is unsupportable in light of the current state of the fuel market. Finally, the Projects note that West Penn added considerable peaking capacity in 1986 (the Bath County Pumped Storage Unit), and that there is nothing on the record to support the proposition that another large peaking unit is needed next.

We agree with the ALJ's recommendation on this issue; further we find compelling reasons supporting West Penn's choice of a coal-fired base load unit as opposed to an oil or gas-fired CT as the next generating plant on the system. Even assuming for the purposes of argument that studies showed a financial advantage to CTs, the advantage was minor at best. West Penn appropriately used its experience and judgment as well as formal studies when formulating its capacity addition plans. Its experience supported the choice of a coal unit for many reasons, including the many years of satisfactory service of coal units to its ratepayers, and the fact that the reason West Penn's rates are the lowest in Pennsylvania and among the lowest in the country is due to the use of coal. The volatility in the supply and price of natural gas and oil as well as the public policy in Pennsylvania of encouraging the use of coal also supported its decision. Additionally, West Penn's high daily load factor supports the decision to add additional base load capacity, as opposed to oil or gas fired peaking units (with low capital costs but high fuel costs), as well as the use of dependent forced outage rates in its studies. In sum, we strongly endorse West Penn's decision to add a coal-fired unit as opposed to an oil or gas-fired CT as its next generating unit. Selection of a CT over a coal unit due to at best a

minor financial advantage produced by a formal study in our opinion would have been unwise. First, it would have exposed ratepayers to the volatility in the supply and price of oil and gas in the future; whereas coal supplies in the APS service territory are abundant and can be procured under long term contract. Second, in our opinion West Penn gave appropriate consideration to the public policy in Pennsylvania of encouraging the use of our indigenous coal resources and the economic benefits in the service territory resulting from the use of coal. The choice of a coal unit over a CT has more than theoretical consequences for the Projects under consideration, even though the Projects are designed to avoid or defer the construction of the next unit by APS. The Projects are themselves capital-intensive as they are designed to utilize coal and coal waste. Generally speaking, a capital-intensive project cannot be supported by capacity credits derived from a low cost combustion turbine. Moreover, we note that OCA did not advocate revising the Projects' *energy* credits (which were not challenged by any party to these proceedings) to reflect the fact that its avoided unit of choice would be fired by oil or gas as opposed to coal. It is an interesting position that advocates capacity rates based on a cheap oil- or gas-fired combustion turbine and energy credits based on coal.

There is an independent reason why basing the capacity credits in this proceeding on a coal plant was required that was not addressed by the ALJ's R.D. As West Penn notes in its Reply Brief, in 1986 it was anticipating inadequate system reliability within the next ten years as a result of not being committed to sufficient plant because its reliability criterion of a 25% reserve margin would not be met without additional generating units. Under 52 Pa. Code § 57.34(c)(4)(iii) this triggers the required use of a coal plant as a proxy. Therefore, in addition to the fact that West Penn reasonably selected a coal plant as its next generating unit, our regulations would have required the payment by West Penn

of capacity credits based on a coal plant even if West Penn had not selected any particular type of generating unit at all.

For all of the foregoing reasons, we find that the capacity credits in this proceeding should be based on the costs of a coal-fired generating unit.

d. *Mitchell and Springdale Units, R.D. at 81-85.*

In 1983 West Penn's Springdale and Mitchell generating units were placed in cold reserve and removed from West Penn's rate base. In the Bath County litigation it was determined that the Springdale and Mitchell units, collectively 361 MW, would not be considered installed capacity for the purpose of evaluating whether the Bath County pumped storage project was excess capacity. WPPII argued that West Penn could return the units to active service by expending $71 million, and that West Penn's capacity credits should have been based on the reactivation costs rather than a new 300 MW coal unit. West Penn responded by noting that its 1986 Generating Capacity Plan showed the need for additional capacity in 1995 *despite* the planned reactivation of Springdale and Mitchell in 1992 and 1993. West Penn also noted that Mitchell and Springdale are oil-fired peaking units, and the Commission's regulations base capacity credits on a peaking unit only when it is due on-line within five years. Since in 1986 Springdale and Mitchell were not "committed" units under the regulations, they were properly not used as the basis of the capacity credits in West Penn's avoided costs calculations.

The ALJ agreed with West Penn's application of the facts to the Commission's regulations at 52 Pa. Code § 57.34(c)(4)(i) and (iii), while disagreeing with West Penn's conclusion that the regulations require the use of costs associated with a new plant, as opposed to one in cold reserve. The ALJ rejected Armco/Allegheny's argument that the capacity credits in these proceedings should

be based on the costs of reactivating Springdale and Mitchell.

No exceptions to the ALJ's recommendation on this issue were filed. We agree with the ALJ and find that the costs of reactivating Springdale and Mitchell were not the proper basis for determining West Penn's avoided costs in these proceedings. West Penn's Generating Capacity Plans in 1986 showed West Penn's need for a 300 MW coal unit in 1995 *in addition to* the planned reactivation of Springdale and Mitchell in 1992 and 1993.

Where a utility projects a need for more than one capacity addition, nothing in our regulations bars the payment of capacity credits based on more than one plant. Therefore, although it was appropriate for West Penn to offer the projects in these proceedings capacity credits based on its 1995 coal plant, West Penn also could have offered capacity credits to other QFs based on the reactivation of Springdale/Mitchell in 1987-1988 (five years before the planned reactivation). Although the resulting capacity credit would have been extremely small, the energy credit associated with Springdale and Mitchell, which are oil-fired, would have been substantially higher than the energy credits at issue in these proceedings. In sum, just as utility capacity addition plans are not mutually exclusive, capacity credits based on different capacity addition plans likewise are not mutually exclusive. In 1986 the appropriate plant upon which West Penn's avoided costs were based was the 1995 coal plant; even if West Penn had planned to reactivate Springdale and Mitchell within five years or by 1991, the Projects in question would have had the choice of which capacity addition plan they would help defer or avoid, which would in turn determine their appropriate avoided costs.

e. *Fixed Charge Rate, R.D. at 85-95.*

West Penn utilizes a levelized annual fixed charge rate ("FCR") to estimate the cost of owning capital assets. The principal elements of the FCR are the cost of capi-

tal, depreciation, income taxes, insurance, and property related taxes. West Penn used a FCR of 17.7% for all three contested Projects. Armco/Allegheny argued for a FCR of 13.88% for Milesburg and 14.65% for Burgettstown and Shannopin. The ALJ concluded that West Penn calculated its FCR correctly and recommended its acceptance.

No exceptions were filed with respect to the ALJ's findings on cost of capital, capital structure, cost of debt, cost of preferred stock, state and federal taxes, ad valorem rate (insurance and property taxes), or rate base. We adopt the ALJ's recommendation on these issues as our own.

Armco/Allegheny excepted to the ALJ's recommendation to adopt West Penn's forecasted return on equity of 15%. West Penn's forecast was made by adding a risk premium of 400 basis points to forecasted bond rates, since it is universally recognized that investments in common stock are riskier than investments in bonds. To encourage investment in common stock, it is necessary to provide a higher return than an investor could receive in the bond market.

Armco/Allegheny argue that the most appropriate return on equity would be the return of 14.25% approved by the Commission in July 1986 in West Penn's Bath County rate proceeding at Docket No. R-850220. Armco/Allegheny argue that only the Commission can set a utility's return on equity, and that West Penn, unlawfully usurped the Commission's authority by forecasting a higher rate of return. Armco/Allegheny state that West Penn committed its ratepayers to pay a higher return on equity to the QF developers than the Commission had required West Penn's ratepayers to pay to the utility.

West Penn's Reply Exceptions note that the return on equity in the FCR for these avoided cost calculations required economic forecasting for the life of the contracts, *i.e.*, as far out as the year 2031 (33 years past 1998). Armco/Allegheny did not contest the reasonableness of

West Penn's projections; rather, Armco/Allegheny contended that using *any* projection was an error of law. West Penn states that Armco/Allegheny's argument defies logic and erroneously assumes that West Penn's return on equity is static and will remain at 14.25% for over 33 years. The Projects' Reply Exceptions note that Armco/Allegheny did not argue that West Penn's forecast was incorrect, and that the rates for each of these Projects were first quoted to developers prior to July 24, 1986, when the return on common equity from the then prior rate case was 15.5%.

Armco/Allegheny's argument on this point requires little discussion. We agree with West Penn that it defies logic to assume that West Penn's rate of return on equity will remain static for the next 30-40 plus years. All components of an avoided cost calculation, including a fixed charge rate, require the use of reasonable projections. The use of a forecasted 15% return on equity did not usurp a Commission function. Therefore, we adopt the ALJ's recommendation on this issue.

f. *Availability Factor.*

Armco/Allegheny have excepted to the fact that, through an oversight, the ALJ's R.D. failed to rule on their argument that the availability factor of the avoided coal unit should have been 80% rather than 75%. The availability factor is the percentage of time during the year that the avoided unit would be expected to operate, and is used as a component in the calculation of West Penn's capacity credit. The lower the assumed availability factor, the higher the capacity credit because the cost of the avoided unit will be spread over fewer Kwh. Armco/Allegheny aver that the newest scrubbed coal-fired units on the APS system are the 621 MW Pleasants Units, which had average availabilities of 80-81% between 1983-1987. Armco/Allegheny aver that, although the only other scrubbed coal-fired unit on the APS system, Mitchell No. 3, had an availability of only 73.9% between 1983-1987, it is more appropriate to use the Pleasants Units

because they are newer and provide a better indication of the expected availability of units that would be built in the mid-1990s.

West Penn's Reply Exceptions state that Armco/Allegheny selectively analyzed APS availability data in order to find an example to support its contention. West Penn takes into account many factors, including potential acid rain legislation, in forecasting future availability. Selections of one four year average availability of one unit does not support an assumption that West Penn should anticipate that particular availability over the economic life of the avoided unit. The Projects' Reply Exceptions similarly state that the selection of only *one* time period for *one* unit does not support use of the corresponding availability factor.

On this issue we agree with West Penn, and reject the argument of Armco/Allegheny. Selection of one four year period for one unit does not support an assumption that the avoided unit would have had an equivalent availability factor over its useful life. Even if the Pleasants Units were selected as the best representative *units* on the APS system, the four year *period* of 1983-1987 selected by Armco/Allegheny occurred very soon after Pleasants Units 1 and 2 were placed in-service in 1979-1980. It is unreasonable to assume that a plant will continue to operate over its 30-33 year life at the same availability factor that it did when it was nearly new. Over time, equipment ages and must be replaced. Therefore, we find that the four year availability factor cited by Armco/Allegheny is not particularly relevant, and adopt West Penn's projection of a 75% availability factor for the life of the avoided unit.

5. *Section 527 of the Code, R.D. at 95-97.*

The ALJ's R.D. rejected Armco/Allegheny's argument that Section 527 of the Public Utility Code, 66 Pa.C.S. § 527, requires discounts from full avoided costs. We

rejected this argument previously in our Order on Reconsideration in these proceedings entered January 19, 1989. Nevertheless, Armco/Allegheny argue that Section 527 applies to negotiated rates as opposed to rates set administratively by the Commisison.

The ALJ rejected Armco/Allegheny's argument as "engaging in legislative mindreading with no support except stretched logic." R.D. at 97. The ALJ concluded that, since Section 527 cannot be used against full avoided cost rates calculated under the Commission's regulations, neither can it be applied to full avoided cost rates in a voluntary agreement. The ALJ notes that, even though not mandated by Section 527, the record in these proceedings demonstrates that the EEPA rates are below West Penn's avoided costs.

Armco/Allegheny's Exceptions at p. 32 repeat their assertion that "Section 527 clearly requires that in Pennsylvania rates paid to QFs should be *less than* avoided costs since this is the only way to provide ratepayers with savings as a result of cogeneration." (emphasis supplied). While conceding that the federal full avoided cost standard applies to rates imposed by the Commission as a result of a complaint proceeding, Armco/Allegheny assert that PURPA does not apply to a negotiated contract. Armco/Allegheny also argue that none of the contracts under consideration provide for savings since West Penn's input assumptions into its methodology were erroneous, and that even if the inputs were correct, the savings under the contracts are not enough.

West Penn's Reply Exceptions state that Section 527 is clear on its face and, rather than mandating discounts from avoided costs, requires only that discounts that do exist be passed on to ratepayers. West Penn states that there is no legislative history to support Armco/Allegheny's interpretation of Section 527, and that any requirement that rates available to QFs in voluntary contracts be below avoided costs would be preempted by federal law.

The Projects' Reply Exceptions characterize Armco/Allegheny's argument on this issue as farfetched, and note that the Federal Energy Regulatory Commission ("FERC") directly addressed the savings issue and mandated that rates to QFs be set at a utility's *full* avoided costs. The Projects echo West Penn's interpretation of Section 527 as requiring utilities to pass any savings that exist to customers rather than retaining a profit on purchases of power from QFs.

On this issue we agree with the ALJ's R.D. Armco/Allegheny's argument is based on stretched logic and, if accepted, would result in an interpretation of Section 527 that would violate federal law. When promulgating its rules under PURPA 210, FERC considered and rejected arguments that rates to QFs should produce savings to customers. FERC mandated that rates for purchases be set at a utility's *full* avoided costs. *Small Power Production and Cogeneration Facilities: Regulation Implementing Section 210 of the Public Utility Regulatory Policies Act of 1978*, Docket No. RM79-55, Order No. 69 (February 19, 1980), 45 *Fed. Reg.* 12214, 12222 (February 25, 1980). The full avoided cost standard was reviewed and approved by the U.S. Supreme Court in *American Paper Institute v. American Electric Power Service Corp.*, 461 U.S. 402 (1983). Therefore, unless and until the full avoided cost standard is revised by FERC, any interpretation of Section 527 as requiring discounts from full avoided costs would be unconstitutional. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941). Armco/Allegheny's argument that negotiated rates are not governed by PURPA is equally invalid. Although FERC's and this Commission's regulations allow a QF to voluntarily accept rates below a utility's avoided costs, there is nothing to support an argument that a utility cannot voluntarily agree to pay full avoided cost-based rates. If this were so, a utility could not voluntarily comply with PURPA 210! Rather, utility compliance with PURPA could be achieved only upon the filing of a formal complaint. This is clearly

unsupported and we reject Armco/Allegheny's argument in its entirety.

6. *OCA's Correction to Milesburg's EEPA, R.D. at 97-100.*

This issue was addressed in Phase I of the ALJ's R.D. We will address it in Phase II. Our intention is that Phase I issues addressed in our Order be applicable to all four proceedings. Issues that are specific to an individual Project will be discussed in Phase II, and our Order(s) in Phase II will be specific as to each individual docket number.

7. *Capacity Costs Allocated on a Demand/Energy Basis, R.D. at 101-105.*

This rate structure issue involves the methodology by which QF capacity payments will be recovered from ratepayers. Currently, all QF costs (energy and capacity) are recovered through West Penn's Energy Cost Rate mechanism ("ECR"). West Penn currently has approximately 135 MW of QF capacity on-line. The Projects in these proceedings represent another 205 MW. While rates paid to Monongahela, Milesburg, Burgettstown and Shannopin will not be reflected in customers' bills until the Projects are financed and constructed, West Penn's existing ECR recovers all costs paid to QFs on an energy or kwh basis. WPPII and Armco/Allegheny advocate recovery of QF capacity payments from ratepayers on a demand/energy basis through the ECR in a manner similar to that which would have occurred if the capacity had been built by West Penn and the costs allocated on cost-of-service principles in base rates. Armco/Allegheny advocated the adoption of a particular mechanism to achieve a demand/energy allocation based on a single coincident peak methodology.

The OCA opposed Armco/Allegheny's proposal on the basis that (1) it would add complexity to West Penn's

ECR; (2) the single coincident peak methodology was not utilized for Bath County; (3) a single coincident peak methodology could result in volatile changes in cost allocations depending on peak responsibility for a single day; and (4) the rate structure issue has not been set for decision by the Commission in these proceedings.

The ALJ concluded that both Armco/Allegheny and OCA were correct. Finding that the reasons for using a demand/energy allocation are sound, but that the allocation should not be set in this proceeding, the ALJ recommended that West Penn be directed to make a demand/energy allocation in its next ECR filing, and that all existing on-line QF capacity be included. OCA excepted, reiterating its position that no action on the rate structure issue should be taken in these proceedings. OCA states that the Commission has never held that it is necessary to determine QF rate structure years in advance of the time when the costs will be collected from customers. OCA also states that no notice was provided to ratepayers that rate structure issues would be determined in these proceedings. North Branch also excepts, stating that West Penn's Petition for Approval of the North Branch EEPA did not request approval to pass the costs through to ratepayers pursuant to any particular allocation method, and that the allocation issue should be decided in a separate proceeding.

WPPII's Reply Exceptions state that the Commission has expressed an unwillingness to review the demand/energy allocation of QF purchased power costs in the context of an ECR proceeding, and that the ALJ recommended only that the *principal* of a demand/energy allocation be adopted in this proceeding, leaving the particular methodology to a later proceeding where all parties will be afforded an opportunity to be heard. WPPII notes that West Penn currently is collecting QF purchased power costs through its ECR. WPPII argues that the rate structure issue is relevant to these proceedings be-

cause rate recognition permits West Penn to recover costs through its ECR mechanism. WPPII states that ratepayer indifference embodied in PURPA should be preserved. Finally, WPPII states that modifying the practice of allocating QF capacity costs on a kwh basis will alleviate any need for industrial intervention in QF development.

Armco/Allegheny's Reply Exceptions state that the demand allocation issue is within the scope of these proceedings because: (1) failure to allocate capacity costs on a demand basis would violate the underlying premise of PURPA of customer indifference; (2) West Penn's rate recovery petitions sought ECR pass through; and (3) the ALJ did not recommend that any particular type of allocation be adopted in these proceedings.

We agree in part with the ALJ's recommendation and adopt the R.D. on this issue up to the conclusion of the first paragraph on p. 104. However, the ALJ's statement that the costs in question will not be recovered until West Penn's next ECR proceeding is inaccurate. The capacity costs at issue in these proceedings will not be recovered for several years as the Projects proceed to financing construction. Therefore, there is no overriding necessity to revise West Penn's ECR in its next ECR filing.

This rate structure issue is one that will take on added importance in the future as utilities begin to substitute purchases from QFs for their own construction. If QFs begin to represent a more significant portion of a utility's installed capacity, continued recovery of capacity charges on an energy basis through a fuel clause mechanism would incorporate a bias against high load factor customers (usually energy intensive industrial customers). While we have strongly supported the continued development of cogeneration and small power production as in ratepayers' best long-term interests, a rate structure bias against a particular customer class certainly would not be our intent. In order to fully analyze the complexities

inherent in a modification to West Penn's ECR so as to achieve ratepayer indifference, we will require a report and recommendation from our Bureau of Audits, with the assistance of the Law Bureau, on how best to proceed. Upon receipt of this report we will determine whether opening a formal investigation into West Penn's ECR or some other action is required. As stated above, the capacity costs currently being recovered through West Penn's ECR are not substantial, and there is no overriding need to implement an ECR modification in West Penn's next ECR filing. Our preference is to proceed on this issue at a slower pace to ensure that the final result will accomplish our objectives. Therefore, we will request the Audits/Law Bureau report within three months of the date of this Order and will endeavor to initiate formal action shortly thereafter.

8. *Excess Capacity, R.D. at 105-107.*

The ALJ recommended a finding that the addition of the QF capacity under consideration does not result in excess capacity under Section 1323 of the Public Utility Code, 66 Pa.C.S. § 1323, with respect to the capacity itself or as to any existing West Penn capacity.

The OCA's Exceptions request clarification of the scope of the excess capacity determination. Specifically OCA requests a finding that the QF capacity in these proceedings *must* be considered in determining whether *future* West Penn plant additions represent excess capacity. No Reply Exceptions were filed.

We affirm the ALJ's decision on this issue. Section 5.3(i) of each of the EEPAs at issue requires, as a condition precedent to West Penn's obligations thereunder, that the Commission either adopt policy guidelines or enter an order to the effect that the QF capacity in question will not be treated as "excess capacity" under Section 1323 either as to the projects themselves or as to any existing West Penn capacity, including the Bath

County project. That determination has been made. We see no need to clarify the determination as OCA has suggested. To do so would constitute ruling on the merits of a case that is not before us and clearly would be improper. However, we note in general terms that it has never been our intention to exclude consideration of existing QF capacity from excess capacity determinations for future utility plant. A more specific statement is not appropriate at this time.

9. *Conclusion.*

Phase I of our Order addresses issues that are applicable to each Project and is hereby adopted with respect to all four proceedings and docket numbers under consideration. Resolution of Phase I issues concludes our Order with respect to the Monongahela and Shannopin EEPA. On the basis of Phase I of our Order, the capacity credits of 3.6¢/kwh and 4.0¢/kwh for Monongahela and Shannopin, respectively, are approved. Orders specific to these two proceedings are appended to this order. Phase II issues remaining for consideration are specific to the Milesburg and Burgettstown Projects. Phase II of our Order in turn will be separated between Docket Nos. P-870216 (Milesburg) and P-880284 (Burgettstown).

B. PHASE II—BURGETTSTOWN

Docket No. P-880284.

North Branch filed a Petition for Modification of its EEPA on April 5, 1989 requesting modification of milestone dates and an increase to its capacity rate to reflect the delay in its in-service date occasioned by the lengthy approval process to which it has been subjected. The capacity credit for Burgettstown was based on the Project being placed in service on October 1, 1991. Among other related milestones, under its EEPA Burgettstown must hold a full financial closing before October 1, 1989 or its EEPA will by its own terms expire. Although West Penn

filed the Burgettstown EEPA with the Commission for approval in January 1988, unforseen circumstances have delayed approval for nearly two years. Without Commission approval of the EEPA in the form of a final and *nonappealable* Commission Order, financing and construction cannot take place. As a result, it is impossible for Burgettstown to meet its contractual milestones. North Branch presented unrebutted testimony that financial closing would take six (6) months from the date of a final and nonappealable order, and that construction would take approximately thirty-three (33) additional months, for a total of thirty-nine (39) months.

The ALJ recommended that North Branch's Petition for Modification be denied. North Branch excepts to the ALJ's failure to recommend modification of the milestones in its EEPA. North Branch also excepted to the failure of the ALJ to recommend an increase to its capacity credit of 3.6¢ Kwh. However, on September 8, 1989 North Branch filed an Amendment to its Exceptions, thereby withdrawing its request for an increase to its capacity credit. Therefore, the only issue before us is whether or not North Branch's request for an extension to its financing and related milestones should be granted.

North Branch states that the ALJ's recommendation not to modify the various milestone dates is illogical because litigation before the Commission has prevented North Branch from meeting the milestones. Although the ALJ recommended that North Branch's EEPA be approved, approval of the EEPA without the requested modification effectively cancels the EEPA and rewards the intervenors for having presented a meritless case. With respect to the ALJ's characterization of North Branch's request for an extension as open-ended, North Branch states it requested six (6) months from a final order for the Financing Closing Date, which is not open-ended. Given the fact that the plant does not have to be in-service until October 1, 1995 to meet West Penn's

needs, the Financing Closing Date could occur as late as January 1, 1993 without presenting a risk to West Penn's planning process. North Branch states that the Commission should consider the environmental and economic benefits of the Burgettstown Project, the substantial savings to ratepayers from the Project, the inequity of not granting the extensions, the great effort and expense incurred by the developers, and the reasonableness of the modifications requested when reviewing North Branch's Exception.

West Penn's Reply Exceptions state that the extensions entail risk to ratepayers that West Penn will not have sufficient time to replace the capacity at a reasonable cost if the Project fails to go in-service at a time when the need is critical. West Penn asserts that projects of this magnitude require years of lead time before construction commences. West Penn states that the developer has the ability to limit its exposure and walk away from the Project at any time, while West Penn does not have the same luxury with respect to its obligation to serve its customers. West Penn states that the ALJ properly questioned whether forced extensions of milestone dates in fully negotiated contracts for an unpredictable period of time should take precedence over a utility's obligation to serve.

Armco/Allegheny's Reply Exceptions argue that the Commission cannot turn a negotiated PURPA contract into a non-negotiated PURPA contract if the resulting contract is not in compliance with federal and state regulations. Armco/Allegheny state that, if Burgettstown is no longer satisfied with its EEPA, it is free to seek a non-negotiated agreement in compliance with the state and federal regulations through the initiation of a new proceeding at the Commission.

We will reverse the ALJ's recommendation on this issue. The Burgettstown Project has been before us for approval since January 1988. Due to unforseen events,

primarily the issuance of the Commonwealth Court decision in *Barasch v. Pennsylvania Public Utility Commission*, 119 Pa. Commonwealth Ct. 81, 546 A.2d 1296 (1988) (*"Milesburg"*) and the resulting necessity to initiate a bill insert notification procedure and evidentiary hearings thereafter, resolution of this proceeding has been delayed substantially. In essence, a proceeding that began as a request for a declaratory order evolved in a vigorously contested rate proceeding that took over twice as long to complete as a major general rate increase proceeding under 66 Pa. C.S. § 1308(d). At today's conclusion of the proceeding, we have affirmed the ALJ's recommendation and found that the Burgettstown EEPA should be approved as providing for rates that are at or below West Penn's avoided costs. If we were to deny North Branch's request for modification to its milestone dates, its EEPA with West Penn would expire by its own terms on October 1, 1989. This result would be untenable, akin perhaps to a doctor meticulously evaluating diagnostic procedures for a patient that died for want of treatment.

In our view it is essential that regulatory delay in the proceeding be recognized and reflected in our Order. To do otherwise would merely extend an open invitation to interventions in opposition to future QF proceedings since intervenors would realize that they could win by default, through the passage of time alone, results that could not be won on the merits. Although we are cognizant of West Penn's concerns regarding orderly capacity planning, our failure to grant North Branch the requested extension would leave an 80 MW shortfall in West Penn's generation plans. If West Penn attempted to make up for the shortfall by beginning the contract negotiation process anew with another developer, we would question the fate of that contract as well in the face of probable opposition and a Commission policy against reflecting and accounting for regulatory delay. To date North Branch has completed substantial development work and

the lengthy review process by the Commission finally has been completed. North Branch is ready to proceed to financing, barring any appeals of our Order. Therefore, to in essence "pull the plug" on the Burgettstown Project at this late stage would inject the very uncertainty in West Penn's generation plans that it seeks to avoid. Similarly, it is no answer to, as Armco/Allegheny suggest, require North Branch to begin anew with a new evidentiary proceeding to obtain a contract with West Penn at rates established under the Commission's regulations. The point of requiring North Branch to begin from square one with a complaint proceeding requesting rates higher than the ones it has accepted is lost to us, unless of course the point is to defeat this Project through a war of attrition.

We therefore will grant North Branch's petition for modification and extend the Financing Closing Date to six months after the issuance of a final nonappealable Commission Order in this proceeding, with corresponding adjustments to related contractual milestones. We also will grant North Branch's August 21, 1989 Application for Stay of the Financing Closing Date in recognition of the fact that, under Section 508, 66 Pa. C.S. § 508, an Order modifying a contractual provision does not take effect until thirty (30) days after it is entered. Therefore, the effect of Section 10.2(c) of the EEPA will be stayed pending the effective date of the portion of our Order granting the contractual modifications.

C. PHASE II—MILESBURG

Docket No. P-870216.

As stated above, Milesburg's contract has been before the Commission and/or the Commonwealth Court since April 2, 1987. The issuance of the Commonwealth Court's decision in *Milesburg* in August 1988 necessitated the preparation and mailing of a bill insert notice and the holding of hearings before an ALJ. The ALJ

has recommended, and we have adopted, an Order affirming the reasonableness of the input assumptions utilized by West Penn's in the calculation of its avoided costs.

The capacity credit of 3.3¢/Kwh in the EEPA was based on an in-service date in 1990. Milesburg's original Financing Closing Date of September 1, 1988 was extended to February 28, 1989 by a Consent Order entered into by all parties and approved by the Commission on September 1, 1988. On February 9, 1989 Milesburg filed a petition to, *inter alia*, further extend its Financing Closing Date. Although the ALJ issued an order on February 21, 1989 granting the petition, he rescinded it on February 27, 1989 in recognition of the fact that it was issued without a hearing as required by Section 508 of the Public Utility Code, 66 Pa. C.S. § 508. N.T. at 7. On March 3, 1989 Milesburg filed a Petition for the Issuance of an Interim Emergency Order or Appeal of Judge Gesoff's February 27, 1989 Order. Milesburg requested that the Commission issue an emergency order granting relief from the Financing Closing Date of February 28, 1989 or, in the alternative, reinstate the portion of the ALJ's February 21, 1989 Order that extended the Financing Closing Date while remanding the issue to the ALJ for a hearing on the merits. West Penn and Armco/Allegheny filed responsive pleadings in opposition to Milesburg's March 3, 1989 emergency petition. By Order entered March 31, 1989 the Commission denied Milesburg's request for an Emergency Order but granted limited interlocutory review of the ALJ's February 27, 1989 Order and required all parties to maintain the status quo with respect to the EEPA pending consideration by the ALJ, and ultimately the Commission, on Milesburg's February 9, 1989 petition for modification. Our Order parenthetically noted that:

> [I]t may be in the interests of West Penn and its ratepayers to retain [Milesburg] under a voluntary agreement setting forth a negotiated rate for the sale

of power. Absent a negotiated rate, [Milesburg] is entitled to a capacity (and associated energy) rate determined in accordance with our regulations. A key issue of first impression would be the time frame to be utilized in determining [Milesburg's] avoided cost-based rate. Although we express no opinion on this issue at this time, our preliminary observation is that [Milesburg's] situation may be distinctly different from the situation considerd by us in *Petition of Pagnotti Enterprises*, Docket No. P-870281 (August 19, 1988). In *Pagnotti*, a negotiated purchased power rate had been approved by the Commission on June 30, 1986, and our June 30, 1986 Order became final and nonappealable on July 30, 1986. The project participants in that proceeding failed to meet, in large part, an agreed-upon financing deadline of December 31, 1986, which occurred approximately five (5) months after the issuance of the final, nonappealable order that is necessary for a project's financing. We found in *Pagnotti* that, by missing the financing deadline, the project participants had waived their entitlement to rates based on Pennsylvania Power & Light Company's ("PP&L's") avoided cost projections as of the time that serious negotiations took place, and that the project therefore was entitled to rates based on PP&L's avoided costs projections as of January 1, 1987. In the instant proceeding, [Milesburg] has never been the beneficiary of a final, nonappealable Commission Order approving rate recovery of amounts proposed to be paid by West Penn. In fact, [Milesburg's] agreement with West Penn has been before the Commission and or the Commonwealth Court for nearly two years. Without a final nonappealable Commission Order, a project such as [Milesburg's] cannot receive financing. Therefore, it may be that, if asked to rule upon this issue of first impression in Pennsylvania, we may determine that

> [Milesburg] has not waived its entitlement to rates based on West Penn's avoided costs as of the time that serious negotiations between West Penn and [Milesburg] took place;

Order at 8-9.

The ALJ recommended that Milesburg's requests to extend its milestone dates and to revise its capacity credit to reflect its delayed in-service date be denied. In the event that the Commission reversed this recommendation, the ALJ recommended that Milesburg's capacity credit be recalculated by incorporating a change in West Penn's methodology to reflect monthly, as opposed to annual, payments.

Milesburg excepted, stating that it has been clearly demonstrated that the requested modified rates are at or below West Penn's avoided costs and substantially below the rates to which Milesburg is entitled under the regulations, and that the Project will bring considerable economic and environmental benefits to Pennsylvania. Milesburg states that the requested modified capacity rates are merely the rates that would have been available to it had the delayed in-service date been anticipated. Milesburg asserts that the ALJ's suggestion that Milesburg initiate another proceeding to seek rates under the regulations is illogical because it would cost the ratepayers more for power. Milesburg argues that there never was any intent that the Commission intended to forego review of Milesburg's request, notwithstanding the fact that its EEPA lapsed on February 28, 1989. Milesburg points to language in the September 1, 1988 Consent Order as indicative of an agreement among the parties that the Commission would consider an extension beyond February 28, 1989. Milesburg further points to the Commission's Order of March 31, 1989 as indicative of the Commission's intent that the petition for modification be considered on the merits. Milesburg avers that if the ALJ had correctly recognized the Commission's intent

and authority to modify the EEPA, the ALJ would have found the modifications to be in the public interest. Milesburg takes specific exception to the conclusion of the ALJ that there is no evidence on the record upon which to conclude that West Penn is hostile to the Projects, since West Penn refused on two occasions to negotiate modifications to the EEPA, and to the conclusion that West Penn would not have sufficient time to replace the Milesburg capacity should it fail to go in-service. Milesburg states that there is no evidence on the record that indicates Milesburg would fail if its milestones were extended, or that West Penn could not replace the Milesburg capacity. Milesburg states that arguably ratepayers would be better off if the milestones were extended since they would not pay for capacity until a date closer in 1995. Milesburg states that it would be erroneous to deny the extensions based on the fact that the Commission's Order may be appealed—rather, the modifications should be decided on the merits as opposed to the fear of appeals by industrial intervenors. Milesburg states it was incorrect to link consideration of the request for milestone extensions with the request for capacity rate modifications since each issue should be viewed separately on the merits. Milesburg objects to the fact that the ALJ gave little consideration to the fact that Milesburg has spent substantial time and money to advance its Project, noting that adoption of the ALJ's recommendation would discourage other developers from risking an undertaking in Pennsylvania.

With respect to the ALJ's recommendation to deny the request for increased capacity rates, Milesburg notes that it is merely attempting to duplicate the EEPA that would have been available to it under West Penn's methodology had the regulatory delay been anticipated, and that it is not inconsistent with the serious negotiations standard to use 1986 assumptions with a modified in-service date for the Project. Finally, Milesburg objects to the ALJ's conclusion that the September 1, 1989 Consent

Order bars any modification to the capacity credit since the rates requested are not in excess of the rates in the EEPA corrected for the new in-service date.

With respect to the ALJ's recommendation to modify the methodology utilized for calculating its capacity credit (in the event the Commission ordered extensions to the milestones), Milesburg states that the reduction would be in error since either the Commission's regulations or West Penn's methodology at the time the EEPA was negotiated is the proper benchmark.

OCA's Exceptions regarding the portion of the R.D. pertaining to modifications to capacity credits state that the ALJ's conclusion that the notice issue would not bar an increase is in error. OCA states that notice would have to be given if any significant increase to the originally noticed EEPAs is granted. Armco/Allegheny similarly excepted to this finding.

West Penn's Reply Exceptions addressed Phase II issues for Burgettstown and Milesburg together. A brief description of West Penn's Reply Exceptions on the milestone extensions is set forth in the previous section of this Order. With respect to the requested increase to the capacity rates, West Penn states that Milesburg's argument that updating the rate is not an increase is a strained reading of the Consent Order. West Penn states that the EEPA automatically terminated on February 28, 1989 and that the Commission therefore has no authority under Section 508 to modify it. West Penn states that the Commission has no authority to order a new contract because avoided costs must be determined at the time a legally enforceable obligation is incurred. West Penn asserts that, since the EEPA lapsed, it has no legally enforceable obligation.

OCA's Reply Exceptions do not address the request for extensions to milestone dates. However, OCA supports the recalculation under West Penn's revised methodology of Milesburg's capacity credit, stating that the purpose

of the proceeding is to determine West Penn's avoided costs and set rates accordingly. With respect to Milesburg's request for an increase to its capacity credit, OCA states that if rates are locked in as of the time of serious negotiations they cannot be revised, and to do so would give the QF the best of both worlds. Finally, OCA states that Milesburg's on-line date of January 1990 was 33 months from the date West Penn's rate recovery petition was filed and that it is unlikely that the on-line date would have been met under any circumstances.

Armco/Allegheny's Reply Exceptions state that Section 508 does not empower the Commission to modify a contract that has lapsed and that an increase to rates would violate the September 1, 1988 Consent Order.

The Project's Reply Exceptions take issue with OCA's and Armco/Allegheny's argument that an additional bill insert would be required before granting an increase to the capacity credits. The Projects state that the bill insert provided all interested parties with sufficient notice of the nature of the hearing, and that the ratepayers are well represented in these proceedings. The Projects state that a new notice is not required by the Commission every time an impact is modified during the course of a rate proceeding.

On Milesburg's Phase II issues, we reverse the ALJ. In our opinion the resolution of these issues is clear. We agree with the ALJ that Milesburg's EEPA has lapsed and that modification to the EEPA under Section 508 is a moot point. Nevertheless, Milesburg has been endeavoring to obtain an approved power purchase agreement with West Penn since 1986. Although West Penn does not have a legally enforceable obligation to purchase power under the lapsed 1987 EEPA, it does have a legally enforceable obligation under PURPA 210 to purchase Milesburg's power at rates determined in accordance with West Penn's avoided cost projections in effect in 1986.

The Commission has the responsibility to enforce the provisions of PURPA 210 in Pennsylvania. Milesburg has requested rates based on West Penn's methodology, which we have determined to be the appropriate benchmark of avoided costs in these proceedings. Milesburg has done nothing to waive its entitlement to rates based on avoided costs as of the time of serious negotiations. Therefore, it is our responsibility to require West Penn to enter into a new EEPA with Milesburg, identical in terms with the lapsed EEPA, with extensions to the milestone dates and revised capacity rates that reflect the Project's later in-service date. Specifically, we will require a financing closing date six months after the issuance of a final and nonappealable Order, with similar extensions to related milestones. With respect to the capacity rates, we find no inconsistency with reflecting the Project's later in-service date in the calculation under West Penn's methodology. All of the inputs regarding West Penn's avoided costs will remain the same. The in-service date is not a component of West Penn's avoided costs, or the cost of the 300 MW coal unit, but a component in the calculation of the QF's ability to defer or avoid West Penn's projected costs. West Penn's avoided *costs* do not change with changes in a Project's in-service date. Rather, a change in the in-service date changes the capacity *credit* while keeping West Penn's avoided *costs* constant.

With respect to the issue of whether or not the Consent Orders bars any increase to Milesburg's capacity credit, a reasonable interpretation thereof is that Milesburg agreed to forego an increase based on the six month extension agreed upon by all of the parties. In other words, a reasonable interpretation is that the *quid pro quo* for getting parties to agree to the limited six month extension was Milesburg's agreement not to seek a capacity credit increase based on that particular six months. Therefore, we will deduct six months from the anticipated financing and construction period of 36-42 months and

set the in-service date at 30 months past the issuance of a final and nonappealable Order in this proceeding.

With respect to the use of the revised West Penn formula, we agree with the ALJ that the capacity credit should be calculated using the revision. West Penn "fine tuned" its methodology after the issuance of price proposals to Milesburg. Since we are requiring the execution of a new contract, the revision should be incorporated.

With respect to the suggestion of the ALJ that Milesburg be required to seek a contract in a new evidentiary proceeding under the Commission's regulations, we find that such a requirement would make no sense. Milesburg should not be denied rates based on West Penn's methodology and forced to seek *higher* rates. Moreover, requiring Milesburg to begin anew with another vigorously contested proceeding likely would result in the abandonment of this Project. For the policy reasons set forth in the section of the Order addressing Burgettstown's Phase II proceeding, we find that a failure in this proceeding to recognize and account for regulatory delay would have consequences contrary to the public interest.

Finally, we agree with the ALJ's recommendation regarding the notice issue. The original bill insert provided adequate notice to ratepayers of the nature of these proceedings. We cannot help but note that all of the active parties to these proceedings were before us before the preparation and issuance of the bill insert. In other words, the bill insert elicited no active parties. Therefore, a finding that a new bill insert would be required before granting Milesburg's request for modified capacity rates would elevate form over substance; THEREFORE,

Petition of West Penn Power Company Re: Monongahela Lock and Dam No. 8.

Docket No. P-880283

IT IS ORDERED:

1. That the Petition of West Penn Power Company ("West Penn") for approval of an Electric Energy Purchase Agreement ("EEPA") with Noah Corporation is granted.

2. That the rates established by the EEPA are approved as just, reasonable, and in the public interest.

3. That West Penn is authorized to fully collect all costs paid pursuant to the EEPA through the Energy Cost Rate ("ECR"), or such mechanism as may replace the ECR in the future.

4. That capacity costs paid pursuant to the EEPA will be recovered through the ECR on a demand/energy basis, the particular methodology for which will be established in a separate proceeding that will be initiated after receipt of an advisory report from the Commission's Bureau of Audits.

5. That the addition of capacity under the EEPA does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn capacity.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 21, 1989

ORDER ENTERED: September 29, 1989

Petition of West Penn
Power Company Re:
Shannopin Mine Project

Docket No.
P-880286

IT IS ORDERED:

1. That the Petition of West Penn Power Company ("West Penn") for approval of an Electric Energy Purchase Agreement ("EEPA") with Mon Valley Energy Corporation is granted.

2. That the rates established by the EEPA are approved as just, reasonable, and in the public interest.

3. That West Penn is authorized to fully collect all costs paid pursuant to the EEPA through the Energy Cost Rate ("ECR"), or such mechanism as may replace the ECR in the future.

4. That capacity costs paid pursuant to the EEPA will be recovered through the ECR on a demand/energy basis, the particular methodology for which will be established in a separate proceeding that will be initiated after receipt of an advisory report from the Commission's Bureau of Audits.

5. That the addition of capacity under the EEPA does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn capacity.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 21, 1989

ORDER ENTERED: September 29, 1989

Petition of West Penn Power Company Re: Burgettstown Project — Docket No. P-880284

IT IS ORDERED:

1. That the Petition of West Penn Power Company ("West Penn") for approval of an Electric Energy Purchase Agreement ("EEPA") with North Branch Energy Partners, L.P. ("North Branch") is granted.

2. That the Petition of North Branch for modification of its EEPA is granted insofar as the Financing Closing Date will be extended to six months after the issuance of a final and nonappealable Order in this proceeding and related contractual milestones will be adjusted accordingly.

3. That North Branch's Application for Stay of the effect the Financing Closing Date is granted.

4. That the rates established by the EEPA are approved as just, reasonable, and in the public interest.

5. That West Penn is authorized to fully collect all costs paid pursuant to the EEPA through the Energy Cost Rate ("ECR"), or such mechanism as may replace the ECR in the future.

6. That capacity costs paid pursuant to the EEPA will be recovered through the ECR on a demand energy basis, the particular methodology for which will be established in a separate proceeding that will be initiated after receipt of an advisory report from the Commission's Bureau of Audits.

7. That the addition of capacity under the EEPA does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn capacity.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 21, 1989

ORDER ENTERED: September 29, 1989

Petition of West Penn
Power Company Re:
Milesburg Energy, Inc.

Docket No.
P-870216

IT IS ORDERED:

1. That West Penn Power Company ("West Penn") is directed to enter into an Electric Energy Purchase Agreement ("EEPA") with Milesburg Energy, Inc. within thirty (30) days of the date on which this Order becomes final and nonappealable. The terms and conditions shall be identical to the 1987 EEPA with the milestone extensions and capacity credit modifications set forth in the foregoing Order.

2. That the rates established by the resulting EEPA are approved as just, reasonable, and in the public interest.

3. That West Penn is authorized to fully collect all costs paid pursuant to the EEPA through the Energy Cost Rate ("ECR"), or such mechanism as may replace the ECR in the future.

4. That capacity costs paid pursuant to the EEPA will be recovered through the ECR on a demand/energy basis, the particular methodology for which will be established in a separate proceeding that will be initiated after receipt of an advisory report from the Commission's Bureau of Audits.

5. That the addition of capacity under the EEPA does not result in excess capacity under Section 1323 of the Public Utility Code as to the capacity itself or as to any existing West Penn capacity.

BY THE COMMISSION,

/s/ Jerry Rich
JERRY RICH
Secretary

(SEAL)

ORDER ADOPTED: September 21, 1989

ORDER ENTERED: September 29, 1989

APPENDIX O

PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PA 17120

Public Meeting Held September 21, 1989
Agenda No: ALJ-124

Docket No: P-870216 P-880283 P-880284 P-880286

PETITION OF WEST PENN POWER

DISSENTING OPINION OF COMMISSIONER
FRANK FISCHL

I must disagree with the majority's resolution of these issues. Each resolution exposes the ratepayers of West Penn Power to escalating expenses and associated risks from purchases from qualifying facilities.

The Office of Consumer Advocate (OCA) and Armco/ Allegheny Ludlum (AAL) have vigorously contested the level of capacity credits. The credits were derived using West Penn's methodology. The OCA and AAL have challenged the level of credits for a number of reasons. Adoption of any one adjustment would substantially reduce the credit payments. Clearly the credits calculated are above avoided cost and should be reduced.

It is ironic for the majority to conclude that these cogeneration contracts are in the best interest of ratepayers when the OCA, representing residential customers and Armco Allegheny, two of the largest industrial customers, believe they are not.

The majority further concludes that the reasonableness of the credits is to be judged by a comparison to rates that would be required by the commission's regulations. It is argued that since credits calculated by commission regulation would be per se reasonable, lower credits calculated under West Penn's methodology are per se reasonable as well.

There are two fatal flaws to this argument. The first flaw is that proper application of the commission's regulation indicates that the qualifying facilities should receive no capacity credits whatsoever. (OCA main brief pages 77-80). The second flaw is the lack of discounting to determine the present avoided cost of future capacity additions. (OCA main brief pages 73-74). In fact, reliance on the commission's regulation *guarantees* rates in excess of avoided costs and therefore violates PURPA. The rate calculated by commission regulation cannot be used as a bench mark because the rate will *always* be greater than the rate under West Penn's methodology due to the lack of discounting. Rather than "binding all in Pennsylvania", the regulation should be waived. It is impossible to argue the per se reasonableness of rates based on regulations that do not apply and that involve a defective formula. Avoided cost cannot be defined by regulations.

The resolutions of the so-called Phase II issues are novel and erroneous. Commission regulations clearly state that "nothing in this subchapter will affect existing contracts or future contracts freely entered into by utilities and qualifying facilities." (52 Pa. Code § 57.32) It is unclear why certain sections of our regulations are "binding" while other sections are completely ignored.

The use of milestones is appropriate. Our regulations state: "A qualifying facility is eligible for a capacity credit as stated in this subchapter only if it enters into a contract or other legally enforceable obligation with the purchasing utility including termination notice requirements and sanctions for noncompliance." (52 Pa.

Code § 57.34) The mutually agreed to financial closing milestone for Milesburg passed unfulfilled on March 1, 1989. The contract does not exist; therefore, Section 508 of the Public Utility Code cannot apply. The majority acknowledges as much. The majority; therefore, ordered West Penn to execute a new contract with the developers. They fail to cite any authority for such action, nor in my opinion does such authority exist.

The Commission has previously answered the question of lapsed milestones. (Petitions of Pagnotti Enterprises, Inc. P-860171, P-870281) Pagnotti held that when a qualifying facility does not meet agreed-upon milestones pursuant to a privately negotiated arrangement, the qualifying facility has waived its entitlement to previously available rates and is entitled only to rates based on "later avoided cost projections." Not only is this precedent ignored, the rates to be paid are actually *increased.* The consent order signed by the parties extending the financial closing deadline clearly bars any increase in the capacity. The majority's "reasonable interpretation" that only an increase based on the intervening six months is barred is contrived and without support.

Milesburg's assertion that if required to initiate another proceeding the rates sought would be higher is incorrect. If the Milesburg developers thought for one minute they could compel higher rates through another proceeding, they would have initiated one by now. Per our regulations, Milesburg is not entitled to capacity credits without a contract. (52 Pa. 57.34)

As for the Burgettstown Project, the majority attempts to use Section 508 of the Public Utility Code to justify the stay and extension of the financial closing date. Suffice it to say that if Section 508 has not been challenged previously, it will be challenged now. For support, the majority characterizes a Commonwealth Court decision as an unforseen event, provides a bizarre medical analogy and suggests that any other conclusion "pulls the plug" on

the project. First, Section 508 should not apply. The inability of certain developers to meet voluntarily agreed to milestone dates simply does not rise to a level contrary or adverse to the public interest and general well-being of this Commonwealth. Second, if applied, the modification is effective 30 days after entry of the Commission order. The Electric Energy Purchase Agreement (EEPA) lapsed October 2, 1989. Again, there is no contract to modify.

The majority has misconstrued the Commission's proper role in this case. The Commission has never approved or disapproved a negotiated contract but has simply approved future cost recovery in the energy cost rate or some similar mechanism. As for Milesburg, the Commission has no idea of the rates being approved because "the particular capacity credit cannot be determined at this time." (Motion of Chairman Shane, page 4) The majority does not know how much, only that it is just and reasonable.

To dismiss energy efficiency as "superficially appealing but groundless" is misguided and unfortunate. (Motion of Chairman Shane, page 2). Was not the spirit of PURPA energy efficiency? Where is the efficiency if consumers are charged equal rates whether the source is Milesburg or West Penn Power?

The demand/energy allocation of capacity charges is a red herring. If the contracts were priced appropriately, no incentive would exist for inter-class cost transfer. A rate structure biased against a particular customer class is not the majority's intent, a level of rates biased equally against all customer classes is quite another matter.

As for the recognition of regulatory delay, if the developers are blameless, then who is to blame? Commonwealth Court, this commission? As to the motives of the intervenors, no reason is given, nor does one exist why intervenors would attempt through hearings and appeals to block bargain priced electricity.

The recognition of regulatory delay shifts more risk onto West Penn's ratepayers. An indefinite financial deadline clearly interfers with utilities' ability to plan future generation. The utility could easily end up capacity short or with excess capacity. The lead time necessary for the coal plants supposedly avoided here is about ten years. Planning is impossible in the present situation where these projects are given open-ended deadlines. Blaming regulatory delay is no answer.

In calculating avoided costs for these contracts, West Penn selected a specific time during the negotiation process at which its risk of relying on a project's capacity for planning purposes is significantly reduced. (Order page 13) Obviously then the financial closing dates were chosen under similar conditions. To suggest that the financial closing could occur at late as January 1, 1993 without presenting a risk to West Penn's planning process is grossly in error. Capacity planning is a continual process necessitating constant update and reevaluation. To suggest that West Penn's planning process be held in abeyance until January 1993 or later is absurd. If there is an 80 megawatt hole in West Penn's generation plan; it has been created by the majority decision.

The Commission regulations were intended to equalize the bargaining power of developers vis-a-vis the utilities. The majority have swung the pendulum too far toward the developers and away from the ratepayers who are the final guarantor of the payments and terms approved here.

This decision has eliminated the need for negotiated contracts. Developers can simply dictate terms and have the Commission order the utility to execute the appropriate contract.

/s/ Frank Fischl
FRANK FISCHL
Commissioner

October 6, 1989
Date

APPENDIX P

Section 210 of the Public Utility Regulatory Policies Act of 1978, 16 U.S.C. § 824a-3. Cogeneration and small power production

(a) Cogeneration and small power production rules

Not later than 1 year after November 9, 1978, the Commission shall prescribe, and from time to time thereafter revise, such rules as it determines necessary to encourage cogeneration and small power production, and to encourage geothermal small power production facilities of not more than 80 megawatts capacity, which rules require electric utilities to offer to—

(1) sell electric energy to qualifying cogeneration facilities and qualifying small power production facilities and

(2) purchase electric energy from such facilities.

Such rules shall be prescribed, after consultation with representatives of Federal and State regulatory agencies having ratemaking authority for electric utilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments. Such rules shall include provisions respecting minimum reliability of qualifying cogeneration facilities and qualifying small power production facilities (including reliability of such facilities during emergencies) and rules respecting reliability of electric energy service to be available to such facilities from electric utilities during emergencies. Such rules may not authorize a qualifying cogeneration facility or qualifying small power production facility to make any sale for purposes other than resale.

(b) Rates for purchases by electric utilities

The rules prescribed under subsection (a) of this section shall insure that, in requiring any electric utility to—

offer to purchase electric energy from any qualifying cogeneration facility or qualifying small power production facility, the rates for such purchase—

(1) shall be just and reasonable to the electric consumers of the electric utility and in the public interest, and

(2) shall not discriminate against qualifying cogenerators or qualifying small power producers.

No such rule prescribed under subsection (a) of this section shall provide for a rate which exceeds the incremental cost to the electric utility of alternative electric energy.

(c) Rates for sales by utilities

The rules prescribed under subsection (a) of this section shall insure that, in requiring any electric utility to offer to sell electric energy to any qualifying cogeneration facility or qualifying small power production facility, the rates for such sale—

(1) shall be just and reasonable and in the public interest, and

(2) shall not discriminate against the qualifying cogenerators or qualifying small power producers.

(d) "Incremental cost of alternative electric energy" defined

For purposes of this section, the term "incremental cost of alternative electric energy" means, with respect to electric energy purchased from a qualifying cogenerator or qualifying small power producer, the cost to the electric utility of the electric energy which, but for the purchase from such cogenerator or small power producer, such utility would generate or purchase from another source.

(e) Exemptions

(1) Not later than 1 year after November 9, 1978, and from time to time thereafter, the Commission shall, after consultation with representatives of State regulatory authorities, electric utilities, owners of cogeneration facilities and owners of small power production facilities, and after public notice and a reasonable opportunity for interested persons (including State and Federal agencies) to submit oral as well as written data, views, and arguments, prescribe rules under which geothermal small power production facilities of not more than 80 megawatts capacity, qualifying cogeneration facilities, and qualifying small power production facilities are exempted in whole or part from the Federal Power Act [16 U.S.C.A. § 791a et seq.], from the Public Utility Holding Company Act [15 U.S.C.A. § 79 et seq.], from State laws and regulations respecting the rates, or respecting the financial or organizational regulation, of electric utilities, or from any combination of the foregoing, if the Commission determines such exemption is necessary to encourage cogeneration and small power production.

(2) No qualifying small power production facility (other than a qualifying small power production facility which is an eligible solar, wind, waste, or geothermal facility as defined in section 796(17)(E) of this title) which has a power production capacity which, together with any other facilities located at the same site (as determined by the Commission), exceeds 30 megawatts, or 80 megawatts for a qualifying small power production facility using geothermal energy as the primary energy source, may be exempted under rules under paragraph (1) from any provision of law or regulation referred to in paragraph (1), except that any qualifying small power production facility which produces electric energy solely by the use of biomass as a primary energy source, may be exempted by the Commission under such rules from the Public Utility Holding Company Act [15 U.S.C.A.

§ 79 et seq.] and from State laws and regulations referred to in such paragraph (1).

(3) No qualifying small power production facility or qualifying cogeneration facility may be exempted under this subsection from—

(A) any State law or regulation in effect in a State pursuant to subsection (f) of this section,

(B) the provisions of section 210, 211, or 212 of the Federal Power Act [16 U.S.C.A. § 824i, 824j, or 824k] or the necessary authorities for enforcement of any such provision under the Federal Power Act [16 U.S.C.A. § 791a et seq.], or

(C) any license or permit requirement under part I of the Federal Power Act [16 U.S.C.A. § 791a et seq.], any provision under such Act related to such a license or permit requirement, or the necessary authorities for enforcement of any such requirement.

(f) Implementation of rules for qualifying cogeneration and qualifying small power production facilities

(1) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) of this section or revised under such subsection, each State regulatory authority shall, after notice and opportunity for public hearing, implement such rule (or revised rule) for each electric utility for which it has ratemaking authority.

(2) Beginning on or before the date one year after any rule is prescribed by the Commission under subsection (a) of this section or revised under such subsection, each nonregulated electric utility shall, after notice and opportunity for public hearing, implement such rule (or revised rule).

(g) Judicial review and enforcement

(1) Judicial review may be obtained respecting any proceeding conducted by a State regulatory authority or nonregulated electric uitlity for purposes of implementing any requirement of a rule under subsection (a) of this section in the same manner, and under the same requirements, as judicial review may be obtained under section 2633 of this title in the case of a proceeding to which section 2633 of this title applies.

(2) Any person (including the Secretary) may bring an action against any electric utility, qualifying small power producer, or qualifying cogenerator to enforce any requirement established by a State regulatory authority or nonregulated electric utility pursuant to subsection (f) of this section. Any such action shall be brought only in the manner, and under the requirements, as provided under section 2633 of this title with respect to an action to which section 2633 of this title applies.

(h) Commission enforcement

(1) For purposes of enforcement of any rule prescribed by the Commission under subsection (a) of this section with respect to any operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility which are subject to the jurisdiction of the Commission under part II of the Federal Power Act [16 U.S.C.A. § 824 et seq.], such rule shall be treated as a rule under the Federal Power Act [16 U.S.C.A. § 791a et seq.]. Nothing in subsection (g) of this section shall apply to so much of the operations of an electric utility, a qualifying cogeneration facility or a qualifying small power production facility as are subject to the jurisdiction of the Commission under part II of the Federal Power Act.

(2)(A) The Commission may enforce the requirements of subsection (f) of this section against any State

regulatory authority or nonregulated electric utility. For purposes of any such enforcement, the requirements of subsection (f)(1) of this section shall be treated as a rule enforceable under the Federal Power Act [16 U.S.C.A. § 791a et seq.]. For purposes of any such action, a State regulatory authority or nonregulated electric utility shall be treated as a person within the meaning of the Federal Power Act. No enforcement action may be brought by the Commission under this section other than—

(i) an action against the State regulatory authority or nonregulated electric utility for failure to comply with the requirements of subsection (f) of this section or

(ii) an action under paragraph (1).

(B) Any electric utility, qualifying cogenerator, or qualifying small power producer may petition the Commission to enforce the requirements of subsection (f) of this section as provided in subparagraph (A) of this paragraph. If the Commission does not initiate an enforcement action under subparagraph (A) against a State regulatory authority or nonregulated electric utility within 60 days following the date on which a petition is filed under this subparagraph with respect to such authority, the petitioner may bring an action in the appropriate United States district court to require such State regulatory authority or nonregulated electric utility to comply with such requirements, and such court may issue such injunctive or other relief as may be appropriate. The Commission may intervene as a matter of right in any such action.

(i) Federal contracts

No contract between a Federal agency and any electric utility for the sale of electric energy by such Federal agency for resale which is entered into after November 9, 1978, may contain any provision which will have the effect of preventing the implementation of any rule under

this section with respect to such utility. Any provision in any such contract which has such effect shall be null and void.

(j) New dams and diversions

Except for a hydoelectric project located at a Government dam (as defined in section 3(10) of the Federal Power Act [16 U.S.C.A. § 796(10)]) at which non-Federal hydroelectric development is permissible, this section shall not apply to any hydroelectric project which impounds or diverts the water of a natural watercourse by means of a new dam or diversion unless the project meets each of the following requirements:

(1) No substantial adverse effects

At the time of issuance of the license or exemption for the project, the Commission finds that the project will not have substantial adverse effects on the environment, including recreation and water quality. Such finding shall be made by the Commission after taking into consideration terms and conditions imposed under either paragraph (3) of this subsection or section 10 of the Federal Power Act [16 U.S.C.A. § 803] (whichever is appropriate as required by that Act [16 U.S.C.A. § 791a et seq.] or the Electric Consumers Protection Act of 1986) and compliance with other environmental requirements applicable to the project.

(2) Protected rivers

At the time the application for a license or exemption for the project is accepted by the Commission (in accordance with the Commission's regulations and procedures in effect on January 1, 1986, including those relating to environmental consultation), such project is not located on either of the following:

(A) Any segment of a natural watercourse which is included in (or designated for potential inclusion in) a State or national wild and scenic river system.

(B) Any segment of a natural watercourse which the State has determined, in accordance with applicable State law, to possess unique natural, recreational, cultural, or scenic attributes which would be adversely affected by hydroelectric development.

(3) Fish and wildlife terms and conditions

The project meets the terms and conditions set by fish and wildlife agencies under the same procedures as provided for under section 30(c) of the Federal Power Act [16 U.S.C.A. § 823a(c)].

(k) Definition of new dam or diversion

For purposes of this section, the term "new dam or diversion" means a dam or diversion which requires, for purposes of installing any hydroelectric power project, any construction, or enlargement of any impoundment or diversion structure (other than repairs or reconstruction or the addition of flashboards or similar adjustable devices).

(l) Definitions

For purposes of this section, the terms "small power production facility", "qualifying small power production facility", "qualifying small power producer", "primary energy source", "cogeneration facility", "qualifying cogeneration facility", and "qualifying cogenerator" have the respective meanings provided for such terms under section 3(17) and (18) of the Federal Power Act [16 U.S.C.A. § 796(17), (18)].

APPENDIX Q

Regulations Adopted By FERC, 18 C.F.R. §§ 292.301 & 304 (1993).

Subpart C—Arrangements Between Electric Utilities and Qualifying Cogeneration and Small Power Production Facilities Under Section 210 of the Public Utility Regulatory Policies Act of 1978

§ 292.301 Scope.

(a) *Applicability.* This subpart applies to the regulation of sales and purchases between qualifying facilities and electric utilities.

(b) *Negotiated rates or terms.* Nothing in this subpart:

(1) Limits the authority or any electric utility or any qualifying facility to agree to a rate for any purchase, or terms or conditions relating to any purchase, which differ from the rate or terms or conditions which would otherwise be required by this subpart; or

(2) Affects the validity of any contract entered into between a qualifying facility and an electric utility for any purchase.

* * * *

§ 292.304. Rates for purchases.

(a) *Rates for purchases.* (1) Rates for purchases shall:

(i) Be just and reasonable to the electric consumer of the electric utility and in the public interest; and

(ii) Not discriminate against qualifying cogeneration and small power production facilities.

(2) Nothing in this subpart requires any electric utility to pay more than the avoided costs for purchases.

(b) *Relationship to avoided costs.* (1) For purposes of this paragraph, "new capacity" means any purchase from

capacity of a qualifying facility, construction of which was commenced on or after November 9, 1978.

(2) Subject to paragraph (b)(3) of this section, a rate for purchases satisfies the requirements of paragraph (a) of this section if the rate equals the avoided costs determined after consideration of the factors set forth in paragraph (e) of this section.

(3) A rate for purchases (other than from new capacity) may be less than the avoided cost if the State regulatory authority (with respect to any electric utility over which it has ratemaking authority) or the nonregulated electric utility determines that a lower rate is consistent with paragraph (a) of this section, and is sufficient to encourage cogeneration and small power production.

(4) Rates for purchases from new capacity shall be in accordance with paragraph (b)(2) of this section, regardless of whether the electric utility making such purchases is simultaneously making sales to the qualifying facility.

(5) In the case in which the rates for purchases are based upon estimates of avoided costs over the specific term of the contract or other legally enforceable obligation, the rates for such purchases do not violate this subpart if the rates for such purchases differ from avoided costs at the time of delivery.

(c) *Standard rates for purchases.* (1) There shall be put into effect (with respect to each electric utility) standard rates for purchases from qualifying facilities with a design capacity of 100 kilowatts or less.

(2) There may be put into effect standard rates for purchases from qualifying facilities with a design capacity of more than 100 kilowatts.

(3) The standard rates for purchases under this paragraph:

(i) Shall be consistent with paragraphs (a) and (e) of this section; and

(ii) May differentiate among qualifying facilities using various technologies on the basis of the supply characteristics of the different technologies.

(d) *Purchases "as available" or pursuant to a legally enforceable obligation.* Each qualifying facility shall have the option either:

(1) To provide energy as the qualifying facility determines such energy to be available for such purchases, in which case the rates for such purchases shall be based on the purchasing utility's avoided costs calculated at the time of delivery; or

(2) To provide energy or capacity pursuant to a legally enforceable obligation for the delivery of energy or capacity over a specified term, in which case the rates for such purchases shall, at the option of the qualifying facility exercised prior to the beginning of the specified term, be based on either:

(i) The avoided costs calculated at the time of delivery; or

(ii) The avoided costs calculated at the time the obligation is incurred.

(e) *Factors affecting rates for purchases.* In determining avoided costs, the following factors shall, to the extent practicable, be taken into account:

(1) The data provided pursuant to § 292.302(b), (c), or (d), including State review of any such data;

(2) The availability of capacity or energy from a qualifying facility during the system daily and seasonal peak periods, including:

(i) The ability of the utility to dispatch the qualifying facility;

(ii) The expected or demonstrated reliabiltiy of the qualifying facility;

(iii) The terms of any contract or other legally enforceable obligation, including the duration of the obligation, termination notice requirement and sanctions for non-compliance;

(iv) The extent to which scheduled outages of the qualifying facility can be usefully coordinated with scheduled outages of the utility's facilities;

(v) The usefulness of energy and capacity supplied from a qualifying facility during system emergencies, including its ability to separate its load from its generation;

(vi) The individual and aggregate value of energy and capacity from qualifying facilities on the electric utility's system; and

(vii) The smaller capacity increments and the shorter lead times available with additions of capacity from qualifying facilities; and

(3) The relationship of the availability of energy or capacity from the qualifying facility as derived in paragraph (e)(2) of this section, to the ability of the electric utility to avoid costs, including the deferral of capacity additions and the reduction of fossil fuel use; and

(4) The costs or savings resulting from variations in line losses from those that would have existed in the absence of purchases from a qualifying facility, if the purchasing electric utility generated an equivalent amount of energy itself or purchased an equivalent amount of electric energy or capacity.

(f) *Periods during which purchases not required.* (1) Any electric utility which gives notice pursuant to paragraph (f)(2) of this section will not be required to purchase electric energy or capacity during any period during which, due to operational circumstances, purchases from qualifying facilities will result in costs greater than those which the utility would incur if it did not make

such purchases, but instead generated an equivalent amount of energy itself.

(2) Any electric utility seeking to invoke paragraph (f)(1) of this section must notify, in accordance with applicable State law or regulation, each affected qualifying facility in time for the qualifying facility to cease the delivery of energy or capacity to the electric utility.

(3) Any electric utility which fails to comply with the provisions of paragraph (f)(2) of this section will be required to pay the same rate for such purchase of energy or capacity as would be required had the period described in paragraph (f)(1) of this section not occurred.

(4) A claim by an electric utility that such a period has occurred or will occur is subject to such verification by its State regulatory authority as the regulatory authority determines necessary or appropriate, either before or after the occurrence.

APPENDIX R

Regulations Adopted By Pennsylvania PUC, 52 Pa. Code § 57.32 (1983).

§ 57.32. Purpose and scope.

(a) *Purpose.* The purpose of this subchapter is to implement the provisions of section 210 of the Public Utility Regulatory Policies Act of 1978, Public Law 95-617, Title II, § 210, 92 Stat. 3144 (16 U.S.C.A. § 824a-3(a)-(j)). To this end, this subchapter details the requirements that utilities and qualifying facilities will have to meet concerning the filing of utility system cost data, the methodology to be used in establishing rates for sales and purchases, the responsibility for interconnection costs, the standards for system safety and reliability, and the processes by which the Commission will attempt to resolve disputes between utilities and qualifying facilities. This subchapter is intended to equalize the bargaining power of qualifying facilities with that of the utilities and protect the interests of the ratepayers. Nothing in this subchapter requires a qualifying facility to take advantage of the provisions of this subchapter. It is up to the qualifying facility to decide whether or not it wants to do so. Furthermore, as detailed in subsection (c), nothing in this subchapter will affect existing contracts or future contracts freely entered into by utilities and qualifying facilities. Long term contracts are encouraged.

(b) *Applicability.* This subchapter governs the purchases and sales of energy or energy and capacity between qualifying facilities and electric utilities.

(c) *Negotiated contracts.*

(1) Nothing in this subchapter:

(i) limits or extends the authority of any electric utility to agree to a price for any purchase or to terms or conditions relating to any purchase which differ from the

terms or conditions which would otherwise be required by this subchapter; or

(ii) affects the validity of any contract entered into between a qualifying facility and an electric utility for any purchase to the extent such contract is valid and in compliance with applicable statutes and regulations.

(2) Each utility shall file with the Commission a copy of any contract or agreement that it enters into with a qualifying facility with a design capacity of 500 kilowatts or more.